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The Economist

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Politics this week

Nov 16th 2006
From The Economist print edition

EPA

President Bush, battered by the mid-term elections, embarked on a long foreign trip seemingly designed to boost his image as a global statesman. He was to drop in on Moscow and Singapore before heading to Hanoi in Vietnam for the summit of ASEAN, the Association of South-East Asian Nations. See article

The victorious **Democrats** served notice that the promised spirit of bipartisanship will have its limits. They say they will block the confirmation of John Bolton's appointment as ambassador to the UN. The White House is still determined to get Mr Bolton confirmed. See article

Senator **Trent Lott**, who was forced to resign from the Republican leadership in December 2002 after he made racially insensitive remarks at a birthday party, returned to the Senate's centre of power by winning election as the minority whip in the next session. Mr Lott will be second-in-command to Senator Mitch McConnell, who replaced Bill Frist as minority leader in the Senate. See article

Work began on a memorial to **Martin Luther King** on Washington, DC's National Mall. King's will be the first memorial there to someone who was neither a president nor a war hero, and the first to a black American. Work is due to finish in 2008.

State within a state

Leaders of **Mexico's** main opposition, the Party of the Democratic Revolution (PRD), called on their legislators to disrupt the inauguration of the new president, Felipe Calderón, on December 1st. The PRD's candidate, Andrés Manuel López Obrador, who narrowly lost the presidential election in July, named a “shadow government” and plans to proclaim himself the “legitimate” president on November 20th. See article

Argentina's President Néstor Kirchner sacked his housing secretary, Luis D'Elía, after he criticised a warrant issued against nine former Iranian officials for helping to plan the bombing of a Jewish community centre in Buenos Aires in 1994. Mr D'Elía is a sympathiser of Hugo Chávez, Venezuela's pro-Iranian president, and a leader of an unemployed workers' movement. See article

Mayhem, continued

EPA

In **Iraq** 11 people were killed at a Baghdad market; more than 35 were killed in American raids; and 20 bound bodies were found in the cities of Mosul and Baquba. Kidnappers, apparently from the interior ministry, abducted dozens of men after storming the education ministry in Baghdad; most were released later the same day.

Mahmoud Ahmadinejad, the president of **Iran,** said that the world now accepted that his country would master the nuclear-fuel cycle. But after a meeting with George Bush, Israel's prime minister, Ehud Olmert, said that Israel could not accept a nuclear-armed Iran, and that he and Mr Bush had “complete understanding” over their approach. See article

Hamas and Fatah were reported to have agreed on Muhammad Shubair, an academic from Gaza who is close to Hamas but not a party member, as new prime minister of the **Palestinian Authority**. But

Hamas continues to vow that it will not recognise Israel. Meanwhile, one Israeli was killed and others injured by a series of rockets fired into Israel from Gaza. See article

South Africa's Parliament voted to legalise same-sex marriages, the first African country to do so. The ruling African National Congress party ordered all its MPs to vote for the bill to bring the law into line with the country's constitution, despite opposition from churchmen and traditional leaders.

With all the votes counted, the incumbent president, Joseph Kabila, was declared the winner of **Congo's** presidential run-off election against Jean-Pierre Bemba. But Mr Bemba's supporters have alleged widespread fraud and the result is likely to be contested in the Supreme Court and on the streets, where the two candidates' private armies have been exchanging gunfire. See article

Severe flooding in eastern **Kenya** has killed at least 21 people and made a further 60,000 or so homeless.

Services delayed

The European Parliament approved a law, much delayed and watered down, boosting cross-border competition in **services** from 2010. Supporters say it could create 600,000 new jobs.

In return for diplomatic help against Iran, America is backing **Russia's** entry bid to the World Trade Organisation. That removes one of the last big obstacles to Russia's membership, although Georgia and Moldova, both of which are suffering Russian sanctions, have yet to confirm their agreement.

Less than two weeks before a planned Russia-EU summit, Poland vetoed the start of talks covering energy, trade and human rights. It wants the Kremlin to lift a ban on Polish food imports and ratify an earlier treaty liberalising Russia's **energy market**.

The Center for Constitutional Rights, an American pressure group, has asked Germany to sue the former defence secretary, **Donald Rumsfeld,** over alleged prisoner abuse in Iraq and Guantánamo Bay. See article

Back on speaking terms

EPA

Senior diplomats from **India** and **Pakistan** resumed talks, broken off after India accused Pakistan's intelligence forces of involvement in bomb blasts in July that killed almost 200 people in Mumbai. They put a little flesh on skeletal proposals for a “joint mechanism” to combat terrorism and build trust.

On the eve of George Bush's departure on his trip that will take in the ASEAN summit in Hanoi at the weekend, America's State Department removed **Vietnam** from a list of countries accused of suppressing religious freedom. But Congress failed to approve a proposal that the two countries normalise trade relations.

After shutting down **Bangladesh** for four days in protest at the alleged bias of the authorities due to oversee elections in January, the opposition called off its national strike, at least until November 20th. See article

In the latest twist in **Taiwan's** continuing corruption scandals, prosecutors interviewed Ma Ying-jeou, the mayor of Taipei and likely future presidential candidate for the opposition Kuomintang, over allegations that he had misappropriated funds. Mr Ma denied any wrongdoing.

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Business this week

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US Airways offered to buy its bankrupt rival **Delta** for $8.7 billion, in a hostile bid analysts hailed as proof that the outlook for America's struggling airlines was improving. The deal would create America's biggest carrier, and might prompt other mergers. See article

The boss of **Deutsche Telekom**, Kai-Uwe Ricke, resigned after shareholders complained about falling profits. The head of the firm's mobile unit, René Obermann, will succeed him. But strict German labour laws will make it difficult for Mr Obermann to pare costs by cutting jobs. See article

Out of fashion

Benetton's chief executive, Silvano Cassano, also quit abruptly. He had rowed with the Benetton family, which owns a controlling stake in the firm, over the fashion retailer's plans to expand internationally. The chief financial officer resigned at the same time. Benetton's shares fell by almost 9% on the news.

The job of Arun Sarin, the embattled boss of **Vodafone**, appeared secure, however, after the mobile-phone operator's results proved better than expected. Earnings for the six months to October reached £6.2 billion ($11.5 billion). The firm projected revenue growth for the full year of 6%.

Sony launched a new games console, the PlayStation 3, which it hopes will revive its fortunes after a year of embarrassing scandals and expensive technical faults. But because of further glitches, the firm could supply Japanese retailers with only 93,000 units, which sold out within hours. See article

In the latest proof of **Gazprom's** growing clout, **ENI**, an Italian energy firm, agreed to cede 3% of Italy's retail gas market to the Russian state-controlled giant. In return, Gazprom will extend contracts to sell gas to ENI, its largest foreign customer, until 2035. The pair also agreed to look for and develop new fields together in Russia and Africa.

General Electric and **Hitachi** agreed to set up joint ventures in America and Japan to vie for contracts to build nuclear power plants. Their main rivals in the industry have already forged similar alliances.

The price of copper and other **metals** dropped as inventories rose. That led to a fall in the shares of mining firms and a slide in the currencies of countries that export lots of minerals, including Australia, Canada and South Africa. See article

Anglo American, a mining conglomerate with big assets in South Africa, said it would invest $4 billion in coal mining and processing in China. Earlier, Larry Yung, a Chinese tycoon, had spent $800m on a 1.1% stake in the firm, in the latest example of Chinese investment in natural resources in Africa.

Deutsche Börse, which runs Frankfurt's stockmarket, dropped its bid to buy **Euronext**, an operator of exchanges in London, Paris, Brussels, Amsterdam and Lisbon. The decision clears the way for a rival offer from the **New York Stock Exchange**, and leaves Deutsche Börse searching for another partner. See article

Meanwhile, a consortium of big **investment banks** unveiled their plans for a new share-trading platform that would compete with European stock exchanges. Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, Merrill Lynch, Morgan Stanley and UBS will all own shares in the new venture.

Russia reached a deal with America on joining the **World Trade Organisation**, a big boost to its 13-year-old campaign for accession. The two countries plan to sign an agreement on November 19th in **Vietnam**, which is about to become the WTO's 150th member. No sooner had Vietnam's WTO

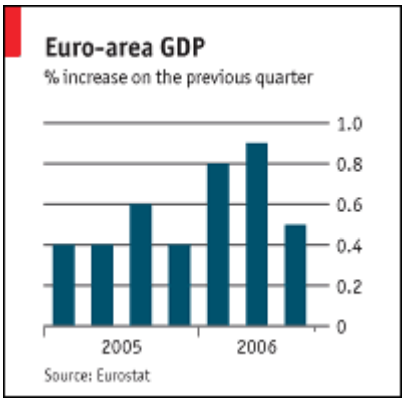
membership been formally approved last week than Intel, a computer-chip maker, announced that it would raise its investments in the country by $700m.

Wace not, want not

Marshall Wace, a British-based hedge-fund manager, plans to raise as much as €1.5 billion ($1.9 billion) on the Euronext stock exchange for a new fund. If successful, MW Tops may be the largest such listing. Traditionally, investors have been able to buy stakes only in funds-of-funds, not individual ones, through the stockmarket. See article

Back down to earth

The **economy of the euro area** grew by a sluggish 0.5% in the third quarter compared with the previous one, according to preliminary estimates. Economists had predicted a better performance, but stagnation in France, lacklustre growth in Italy and a slowdown in Germany all weighed on the numbers. **Japan's** GDP also expanded by 0.5% in the third quarter compared with the previous one, but that was higher than most economists had forecast. Compared with the same period last year, the economy grew by 2.7%. See article



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Alternative energy

Green dreams

Nov 16th 2006
From The Economist print edition

The flood of money into clean energy is better news for society than it is for investors

Reuters

COMPUTER chips and solar panels are made of the same basic stuff: thinly sliced silicon. Until recently, however, Silicon Valley did not take much interest in the alternative use of its principal raw material.

That has changed. California's entrepreneurs are piling into clean-energy technology. In June a group of Silicon Valley luminaries invested $100m in Nanosolar, a firm which hopes to cut the cost of producing solar panels dramatically. The investors include some of the founders of eBay, the world's biggest online auctioneer, and Germany's SAP, a giant software firm. Nanosolar's seed money came from Sergey Brin and Larry Page, who started Google. Last month their “do no evil” search-engine company announced plans to build the largest corporate solar-power installation at its Silicon Valley campus. The panels will supply about 30% of its electricity.

One estimate puts the total investment going into clean energy at $63 billion this year, up from $49 billion last year and just $30 billion in 2004. Some supposedly green business is more relabelling than revolution—companies flogging slightly more efficient versions of standard technologies as exciting innovations—but there is also a flood of money into new energy technologies. Clean energy now gobbles up almost a tenth of America's venture capital. After years of wondering what would be the next big thing after the dotcom boom, America's technology industry is betting on alternative energy (see article).

This is excellent news for society. More private-sector investment in green technologies will mean cheaper clean energy, lower fossil-fuel consumption and a greater chance of averting serious climate-change. It may not, however, be such good news for investors.

Déjà vu all over again

Displays of excessive enthusiasm for particular new technologies often end in tears. In the late 1990s, investors poured money into telecoms firms and dotcom start-ups. Some of the wild claims made at the time proved to be justified eventually, but not before around $1 trillion of value had been destroyed and many investors had lost their shirts.

The comparison is inexact. Nothing like as much money is going into clean energy as went into telecoms and internet firms. And there are solid, long-term reasons to expect demand for clean energy to grow.

Governments do not want to rely on faraway, unstable or downright hostile countries for oil and gas. They are also increasingly concerned about pollution, especially in the form of the greenhouse gases that cause global warming. Most importantly, high fossil-fuel prices make alternatives look far more affordable and attractive.

Clean energy is also getting cheaper. The cost of wind-power generation has come down from 8-10 cents to 3.5-4 cents per kWh since 1990 because of better turbines and higher volumes. Solar-power prices have dropped too. The first cells, in satellites, cost about $200 per watt of generating power. By last year the price had fallen to about $2.70 per watt. The more money goes into the sector, the faster prices will fall.

But although the price gap between electricity generated by fossil fuels and that generated by alternatives has shrunk, it still exists. Making biodiesel remains more expensive than producing the non-bio sort. Burning natural gas is still a cheaper way of generating power than using wind turbines. And coal, the dirtiest of all energy sources, is still by far the cheapest. For the time being, clean energy is competitive in only a few countries in certain specific instances: solar power for retail electricity consumers in Japan, say, or ethanol made from sugarcane in Brazil. The sort of advances that will really change the world, such as ethanol that can be made cheaply from grass or trees, or solar cells that can be painted onto almost any surface, remain a distant prospect.

Almost all clean energy therefore relies on government subsidies to make it competitive with fossil fuels. For the moment, politicians seem quite happy to pay up. No fewer than 49 governments, according to Goldman Sachs, an investment bank, have established targets to promote greater use of renewable energy sources: the voters pay, either through higher prices or through direct subsidies.

So hip, so hot, so green

As far as voters are concerned, this is probably a reasonably good use of public money. Climate change is a real problem and the only way to tackle it is to reduce the gap between the price of fossil-fuel energy and alternative energy. But subsidies are not the best way to achieve that goal. Governments that try to pick winners often choose losers. Subsidies distort investment: since the German government fixed the price for solar power at munificent levels, the country has been sucking in huge numbers of solar panels that could be put to better use in sunnier climes. A global carbon tax would be a more efficient way to close the price gap between fossil and alternative fuels. But that solution is a long way off. In the meantime, subsidies for alternatives are probably better than no action.

That's true for voters. But government subsidy is a wobbly foundation on which to build a business. Politicians are a fickle lot. Environmentalism is hot right now: it even featured on a recent cover of *Vanity Fair*, with Julia Roberts as a green fairy, George Clooney fetchingly attired in peasant gear and Al Gore brooding earthily. But fashions fade, and voters may begin to question the logic of certain subsidies as ever more firms take advantage of them and the bills begin to rise. As it is, the industry's fortunes rise and fall with the level of official largesse. Wind power in America, for example, inflates and deflates on a two-year cycle, as a particular tax credit is renewed and then lapses again.

Society should rejoice that greenery is in vogue. Markets too will over the long term come to value the technologies in which the clean-energy business is investing. In the short term, though, the prospects of a business so dependent on the whims of politicians are bound to be uncertain. Some investors are sure to see their shirts blown away in the wind.

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America in the Middle East

Reaching out to Iran and Syria

Nov 16th 2006
From The Economist print edition

Worth a try, but it would be a mistake to expect too much

EPA-AFP

“IT'S good to talk”, says the snappy slogan of a British telecoms company. And so it generally is, especially if the alternative to talking is fighting. But does this really amount to a transforming idea for America in the Middle East?

You might think so, to judge by the fuss being made about what could be gained if only America extended a hand of friendship to Iran and Syria. Doing this would certainly be a climbdown for George Bush. This president memorably consigned Iran (with Iraq and North Korea) to an “axis of evil” in January 2002. Syria was added later. At their moment of maximum hubris, the American neoconservatives hoped that toppling Saddam Hussein would lead swiftly on to the fall of the theocracy in Tehran and the dictatorship in Damascus. Democracy would spread its healing balm through a new Middle East, easing the passage to peace in Palestine.

After the debacle

How naive these imaginings sound now. Mr Bush is floundering in Iraq and has a duty to explore every new idea with an open mind. Talking more openly to Iran and Syria is one of these, and is expected to figure prominently in the report of the bipartisan Iraq Study Group being prepared for Congress by James Baker, who was secretary of state when Mr Bush's father was president. But although some sort of dialogue with Iran and Syria could indeed help—not only in Iraq but also in strife-torn Lebanon and Palestine—talking is no panacea. To invest too much hope in it would be naive in its turn.

The first reason for this is that even if they wanted to help, neither Iran nor Syria can in practice offer all that much in Iraq. Tony Blair, Britain's prime minister, said this week that “a major part” of the answer to Iraq lies outside the country, in the region as a whole. He is wrong. It is true that outside forces, such as foreign Sunni jihadists and Shia militias supported by Iran, have played a part in fomenting the violence now under way. But the sad truth is that Iraq is falling apart mainly for internal reasons, as Sunnis reject a new political order dominated by Shias. Iran's influence on Iraq's Shias is limited, and it has none at all over the Sunnis. As for Syria, it is only a bit player: a conduit for foreign jihadists whose role in what has become a sectarian civil war is diminishing fast.

A second reason to be wary of investing too much hope in Iran and Syria is that the outlook, instincts and interests of both regimes are sharply in conflict with America's—and they are likely to remain in

conflict no matter how rich a dialogue these countries enjoy with the United States.

Iran's aims seem to include building a nuclear weapon, thwarting America in Iraq, destroying Israel and spreading the ideas of its 1979 revolution, which is now, after the rout of Iran's reformists, enjoying a second wind. The aims of Syria's President Bashar Assad are to survive as dictator, restore his control over Lebanon, escape investigation of Syria's part in the murder of that country's former prime minister and block progress towards a deal between Israel and the Palestinian moderates by supporting the rejectionists of Hamas.

The fact that the interests of Iran and Syria are in so many cases the opposite of America's is no reason not to talk. As America's foreign-policy “realists” such as Mr Baker and Henry Kissinger have long argued, talking to foes is often essential. Sometimes this can lead to a sudden breakthrough—as when Richard Nixon went to China or Yitzhak Rabin dropped his refusal to talk to Yasser Arafat. America and the Soviet Union talked constantly during the cold war, even though their global ambitions were utterly incompatible. Even talks that do not produce a breakthrough can permit useful horsetrading of the sort that makes a conflict a little bit safer.

It would be lovely to believe that talking to Iran and Syria could fall into the first category: the sort of negotiation that might lead to a breakthrough. Many thoughtful diplomats have called for just such a “grand bargain” between America and Iran. But bringing one about would be a very tall order. Iran would have either to abandon its efforts to build an atomic bomb and cause the destruction of Israel, or America would have to give up its opposition to these things. The latter seems out of the question. No American president or Congress would want to give their blessing to a nuclear-armed Iran continuing to threaten the Jewish state with destruction. At most, this is a situation America might be forced reluctantly to live with, if diplomatic efforts to stop Iran's bomb fail and if Israel and America balk at resorting to military means.

A theory worth testing

Is Iran any more likely than America to cave in? Perhaps: but the expectation that it might is based on a reading of its motives that may or may not be correct. Some say that Iran's threats against Israel are merely rhetorical and that its quest for a bomb is based primarily on a fear of America. This proposition is worth testing. While pressing Iran on its nukes, Mr Bush should make it very much plainer than he already has that America has no desire to remove the regime. If this message were transmitted loud and clear, and better still combined with real progress towards a just peace in Palestine, the makings of a grand bargain might just fall into place.

Or not. For there is a rival theory about Iran. This holds that it wants a bomb not out of fear but because of ambition: an ambition to dominate its region and enact a revolutionary ideology, of which eliminating Israel is an inseparable and even sacred part. It has already rejected an offer of aid, and talks with America, in return for suspending uranium-enrichment in line with the demands of the UN Security Council. If this gloomier theory is right, the best that talking will achieve is not a breakthrough but some horsetrading on the side.

Before those sorts of talks, however, America needs a clear idea about what it is actually willing to trade. Let Iran go nuclear in return for some help on the margin in Iraq? Hand Lebanon back to Mr Assad in order to split Syria from Iran? Surely not. It is good to talk, but expecting too much from Iran and Syria would be a mistake. The place to resolve America's problems in Iraq is still, unfortunately, Iraq itself.

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Organ transplants

Psst, wanna buy a kidney?

Nov 16th 2006
From The Economist print edition

Governments should let people trade kidneys, not convict them for it

Science Photo Library

IF THEY were just another product, the market would work its usual magic: supply would respond to high prices and rise to meet surging demand. But human kidneys are no ordinary commodity. Trading them is banned in most countries. So supply depends largely on the charity of individuals: some are willing to donate one of their healthy kidneys while they are still alive (at very little risk to their health); others agree to let their kidneys be used when they die. Unsurprisingly, with altruism the only incentive, not enough people offer.

Kidneys are the subject of a quietly growing global drama. As people in the rich world live longer and grow fatter, queues for kidneys are lengthening fast: at a rate of 7% a year in America, for example, where last year 4,039 people died waiting. Doctors are allowing older and more sluggish kidneys to be transplanted. Ailing, rich patients are buying kidneys from the poor and desperate in burgeoning black markets. One bigwig broker may soon stand trial in South Africa (see article). Clandestine kidney-sellers get little medical follow-up, buyers often catch hepatitis or HIV, and both endure the consequences of slap-dash surgery.

The Iranian model

In the face of all this, most countries are sticking with the worst of all policy options. Governments place the onus on their citizens to volunteer organs. A few European countries, including Spain, manage to push up supply a bit by presuming citizens' consent to having their organs transplanted when they die unless they specify otherwise. Whether or not such presumed consent is morally right, it does not solve the supply problem, in Spain or elsewhere. On the other hand, if just 0.06% of healthy Americans aged between 19 and 65 parted with one kidney, the country would have no waiting list.

The way to encourage this is to legalise the sale of kidneys. That's what Iran has done. An officially approved patients' organisation oversees the transactions. Donors get $2,000-4,000. The waiting list has been eliminated.

Many people will find the very idea of individuals selling their organs repugnant. Yet an organ market, in body parts of deceased people, already exists. Companies make millions out of it. It seems perverse,

then, to exclude individuals. What's more, having a kidney removed is as safe as common elective surgeries and even beauty treatments (it is no more dangerous than liposuction, for example), which sets it apart from other types of living-organ donation. America already lets people buy babies from surrogate mothers, and the risk of dying from renting out your womb is six times higher than from selling your kidney.

With proper regulation, a kidney market would be a big improvement on the current, sorry state of affairs. Sellers could be checked for disease and drug use, and cared for after operations. They could, for instance, receive health insurance as part of their payment—which would be cheap because properly screened donors appear to live longer than the average Joe with two kidneys. Buyers would get better kidneys, faster. Both sellers and buyers would do better than in the illegal market, where much of the money goes to the middleman.

Instinct often trumps logic. Sometimes that's right. But in this case, the instinct that selling bits of oneself is wrong leads to many premature deaths and much suffering. The logical answer, in this case, is the humane one.

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Mexico

Time for the real president to stand up

Nov 16th 2006
From The Economist print edition

The cure for Felipe Calderón's weak mandate is boldness

AP

Get article background

ON DECEMBER 1st Felipe Calderón, a conservative democrat who narrowly won an election last July, is due to be sworn in as Mexico's next president. He promises to strengthen the rule of law and his country's democratic institutions, promote job creation and fight poverty. Unfortunately his noble intentions risk being drowned out by much background noise. On November 20th Mr Calderón's defeated opponent, Andrés Manuel López Obrador, plans to proclaim himself the “legitimate” president. He has already named a “shadow government”. The leaders of Mr López Obrador's centre-left party have ordered their legislators to disrupt Mr Calderón's inauguration. So the bitter aftermath of the presidential election continues to poison what is still a young democracy. That is worrying not just for Mexico itself but also for those in the United States who wish to see fewer Mexican migrants crossing the Rio Grande in search of the opportunities that their own country is not providing.

At first glance it would be easy to dismiss Mr López Obrador's actions as the inconsequential tantrums of a sore loser who was never able to substantiate his charge of electoral fraud. Certainly most of his fellow countrymen seem to take this view. But a substantial minority do not. A poll commissioned recently by the independent electoral authority found that 37% of respondents believed that fraud took place. Many of those would doubtless prefer a constructive opposition to constant rabble-rousing. Mr López Obrador's party has plenty of reasonable leaders who have indicated that they will work with Mr Calderón. The “shadow government” is made up of second-tier figures.

The difficulty is that Mr López Obrador's supporters also include radical groups on the fringes of the law of the kind that have helped to bring the southern city of Oaxaca, an erstwhile tourist magnet, to a halt over the past five months as demonstrators struggle to oust an unpopular and thuggish state governor. It is not hard to imagine the new government being dragged into a quagmire, its authority constantly tested by quasi-insurgencies in Mexico's poorer centre and south, which voted heavily for Mr López Obrador.

In a broader sense, the election showed that Mexico is finely poised between progress and frustration at the lack of it (see survey). A dozen years ago the North American Free-Trade Agreement seemed to set the seal on its move towards an open market economy after decades of state-led protectionism. Similarly, Vicente Fox's defeat of the long-ruling Institutional Revolutionary Party (PRI) in 2000 marked the culmination of a gradual transition to democracy. But Mr Fox failed to get many of his promised reforms through a gridlocked legislature. Economic growth has disappointed. Above all, the remnants of

its past corporate state are holding Mexico back. They include an education system badly run by a powerful trade union, police forces that are useless at the detection and prevention of crime, a public monopoly of energy, and private oligopolies in, for instance, telecoms.

Can Mr Calderón provide reform, a stronger democracy and faster growth? That would be hard even for a president with a clearer mandate. Mexico needs a great many reforms, several of which will require constitutional change. To gain a legislative majority, the new president will need to do a deal with the PRI. It will be a troublesome ally, as its obdurate defence of the discredited governor of Oaxaca has shown. And Mr Calderón will probably need the votes of some in Mr López Obrador's party as well if he is to get the two-thirds majority needed for constitutional change.

Appealing beyond his own constituency

To his credit, the new president's policy proposals show a pretty clear understanding of many of the problems. Though younger than Mr Fox, he has more political experience. He also has relatively few political debts: his business backers owe him more than he owes them.

Mr Calderón's task is to build himself a stronger mandate. To do so he will have to act quickly and boldly, and appeal beyond his own constituency. Some measures, such as tax reform or allowing private investment in energy, will require negotiation in Congress. Others are in his own hands: for example, more money for roads and other infrastructure in the south, or a tougher competition policy applied rigorously to the likes of Telmex and Televisa, the telecoms and media giants. Taking on so many bastions of privilege at once will be risky. But doing nothing is a bigger risk.

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Tibet

Hu's afraid of the Dalai Lama

Nov 16th 2006
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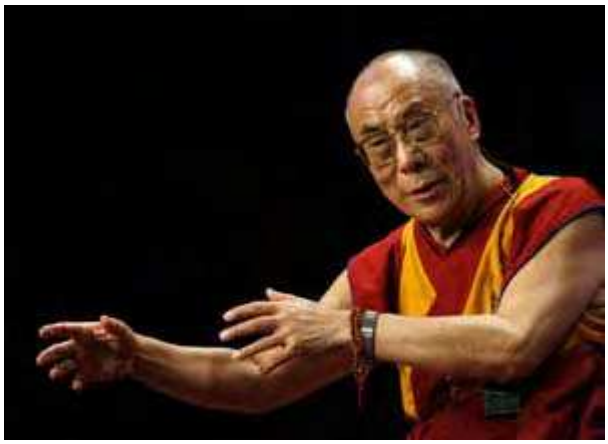
China's policies on Tibet should be challenged, not connived at

Reuters



ONE of the many reasons Indians justifiably feel proud of their political system has been their country's historic generosity to the downtrodden. In particular, the shelter it has provided since 1959 to the Dalai Lama, the exiled spiritual leader of Tibet, and, by now, some 100,000 of his followers is an outstanding example of national hospitality. India is still a poor country that in the 1950s saw China, the Tibetans' oppressor, as a “brother”. Yet it provided a home big enough to accommodate the dream of Tibetan cultural survival.

So it is sad to see India follow the West in helping China by making even the limited political space available to Tibetan exiles even smaller. This week, for example, as India prepares to receive Hu Jintao, China's president, from November 20th (see article), it slapped a travel ban on Tenzin Tsundue, a young Tibetan activist in Dharamsala, seat of Tibet's government-in-exile. Mr Tsundue has staged protests when other Chinese leaders have come calling.

India is not alone in shielding Chinese leaders from protests. It is also far from unique in submitting to the Chinese water-torture of diplomatic negotiation by semantic stealth. So in 2003 it moved from “reiterating that Tibet is an autonomous region of China” to “recognising that the Tibet Autonomous Region (TAR) is part of...China”. The seemingly trivial word-tinkering matters. The TAR is neither Tibet, which historically was much larger, nor at all autonomous.

That concession, like Mr Hu's visit, was part of a gradual thaw with China. “Brotherhood” was exposed as a sham by China's swift victory in a bitter war in 1962. Much has impeded the two countries' patching-up since: the lingering suspicions left by India's humiliating defeat; the unresolved territorial row that caused the war; China's “all-weather” friendship with Pakistan; and India's provision of a base for the Dalai Lama, whose Hollywood stardom, Nobel peace prize and access to world leaders have kept alive an issue China wishes long buried. It is also irksome that growing numbers of Chinese are interested in Tibetan Buddhism.

Yet better relations are very much in China's interests as well as India's. As India emerges as a regional economic power, there are many in Washington who see it as an obvious counterweight to China. The “strategic partnership” India and America are building is not, both sides insist, intended to “contain” China. But China's fear of that outcome gives India negotiating power. It need not compromise on Tibet.

Make the deal while the Dalai Lama still lives

Much as it fulminates against the evil “splittist” shenanigans of the Dalai Lama, China knows it is winning the diplomatic battle. No government on earth recognises his exiled administration. And he is 71 and cannot live forever. The Dalai Lama's followers argue that this is why China should take advantage of his willingness to negotiate with them. No future leader will enjoy the devotion and obedience the Dalai Lama commands. He has always preached non-violence. And he is asking not for the independence many Tibetans feel is their birthright, but for “a middle way”, genuine autonomy, or, put another way, for China to live up to its professed policies.

Bizarre evidence of the Dalai Lama's continued sway over many of the 6m Tibetans still in their homeland came earlier this year in the form of tiger-skin bonfires. Wearing the skins had become fashionable in Tibet, to the alarm of those seeking to save the species. The Dalai Lama's intervention, telling his people the fashion was “silly”, persuaded many to give it up.

Disaffection with Chinese rule remains widespread. Up to 3,000 Tibetans still sneak across the border to Nepal and India every year. A video shot by a foreign mountaineer in September, showing a young nun being shot by Chinese border guards, was a bleak reminder of the risks they run. Last month, Tibetan students protested in the capital, Lhasa, after civil-service examinations had resulted in 98 out of 100 jobs going to ethnic Chinese. Tibetans fear that their cause and culture will soon be swamped by an influx of Chinese.

If China wants accommodation with its Tibetan minority, the Dalai Lama's “middle way” is an historic opportunity. But despite five rounds of talks since 2002 with his representatives, there is little sign that China wants such an accommodation. It seems content to rely on the distant hope that economic development will dampen nationalist fervour, and the more certain methods of Chinese immigration and political repression. There may be little the outside world can do to influence this. But it could at least try.

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Hedge funds

Mutiny about the bounty

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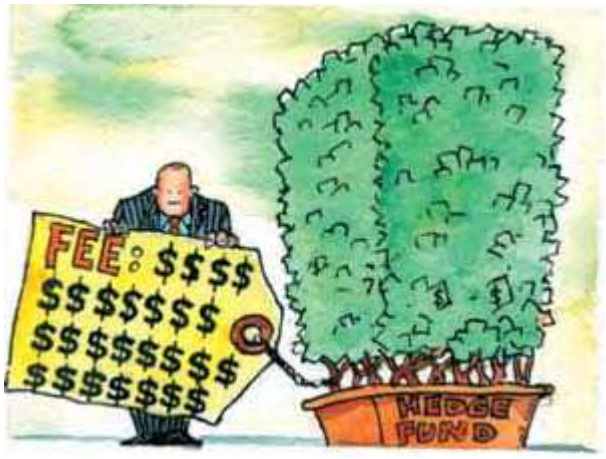
The risks from hedge funds are not that high. Nor, investors should note, are the rewards



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PAY peanuts and you get monkeys. Most people assume the corollary must be true: pay handsome fees and you get superior people and an excellent standard of service. That certainly seems to be the assumption in the hedge-fund business, where investors are willing to pay not only a high annual fee but also a fifth of all profits to get access to the world's best money managers.

The trouble is that hedge-fund managers are not producing the kind of bonanza they used to in the days when George Soros, the man who famously “broke the Bank of England” on Black Wednesday in 1992, dominated the sector. In the 1990s, their compound annual return was 18.3%; since 2000, it has been just 7.5%. True, other asset classes, notably shares, have also delivered disappointing results in recent years. But that only illustrates the point that hedge-fund returns are not conjured from thin air: they are significantly dependent on the fortunes of financial markets in general.

There is, to be sure, a degree of skill involved too. Hedge-fund managers can be adept at exploiting pricing anomalies as well as obscure market niches. But those opportunities will diminish as more and more capital pours into the industry. Hedge funds' assets have increased more than thirtyfold since 1990, and they are now competing with traditional financial companies such as banks and private-equity firms (see article). Academic research is also breaking down the mystique of hedge-fund managers and suggesting that it may be possible to replicate their returns using low-cost strategies in the futures markets.

This creates a problem for investors. In a period of low inflation, the fees charged by hedge-fund managers absorb a large proportion of nominal returns. This is particularly the case when clients invest through a fund-of-funds; one academic reckons the hedge-fund take can be as much as 40% of portfolio returns. That makes it hard to see how the process can be worthwhile for the client.

Of course, this system is extremely good news for the managers themselves. Hedge-fund titans regularly top the list of the world's greatest earners, thanks to the performance fees that kick in when they do well. They are a lucrative source of revenue for the brokers they deal with. And the sector is so attractive that investment banks—Morgan Stanley being a prime recent example—are desperately trying to buy themselves a seat at the table.

Media interest in hedge funds is focused on the collapse of Long-Term Capital Management in 1998 and the risks to the financial system of a similar debacle. But recent hedge-fund disasters, such as the misadventures of Amaranth Advisors, which gambled heavily and lost in the energy markets, have barely caused a ripple. Most hedge funds quietly expire when they become unprofitable to run rather than collapsing in a blaze of ignominy.

The low volatility observed in the markets for currencies, bonds and shares suggests that hedge funds have helped to stabilise the system. Indeed, part of the reason investors are moving into hedge funds is that they are, on average, a lot less risky than stockmarkets. No doubt hedge funds will be at the centre of the next financial disaster, as one regulator recently observed; but that is because they are at the centre of everything that happens in financial markets these days.

High time for hedge-trimming

What ought to concern investors more is whether they are getting value for money. Pension funds are being pushed by consultants into hedge funds to reduce their overdependence on shares and as an alternative to low-yielding bonds. But they need to focus on price. The expansion of the industry should have led to competition on fees; instead, fees seem to be drifting higher. More of the big pension funds should follow the example of the Dutch group ABP and use their market power to fight back on fees; smaller pension funds should walk away rather than pay too much. There is no need to transfer yet more money from the retirement savings of ordinary employees to the grandees of Greenwich, Connecticut, and Mayfair, London. Hedge-fund fees are overdue for trimming.

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On Nancy Pelosi, retailing, the United Nations, Kazakhstan and Europe, America's economy, climate change

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A united front for Pelosi

SIR – I failed to see the point of your profile on Nancy Pelosi, the Democrats' leader in Congress (Lexington, November 4th)? Apparently she is very wealthy. Really? Bill Frist is not? She also often "talks drivel". Republicans constantly harping on about a credible connection between Saddam Hussein and al-Qaeda. That wasn't drivel? Plus she uses "clumsy alliteration". Can I quote this from Dick Cheney: "A dunk in the water is okay, but we don't torture."

Seemingly, Ms Pelosi is also a hybrid of "a Stepford wife and Jesse Jackson", though this doesn't quite square with your other observation that she was astute enough to deprive the White House of a victory on Social Security. She is "robotic" to boot, but somehow I don't think she is quite as robotic as Republicans chanting their mantra of "stay the course" (which they have now dropped). She is also "tough" because she keeps her party members in line and "forced the Republicans to resort to all sorts of dubious methods to get controversial legislation past a near-united opposition". Goodness. Next we'll find out that she pressured the Republicans into becoming intertwined with Jack Abramoff so that she could become the next speaker.

Charles Freifeld
Brookline, Massachusetts

SIR – I think you give Ms Pelosi too much credit for the current unity of her party. A bigger factor is the peeling away of conservative Southern Democrats towards the Republicans. This has reduced the Southern, and thereby fractious, influence, among Democrats. This Southern influence is now at its lowest level in the party for decades.

Donald Berg
Portland, Oregon

SIR – The illustration on your cover a week before the mid-term elections depicted vultures gathering over Congress (November 4th). I think you chose the wrong bird. A more accurate statement would be that the chickens have come home to roost.

Georgy Lannon
Portsmouth, New Hampshire

Shopping around

SIR – Foreign retailers may well want to move into India's immense consumer market ("Setting up shop in India", November 4th). However, they should bear in mind two factors that have enabled supermarkets to become successful in rich countries. These are the availability of a vehicle to carry the goods home and the ability to refrigerate and store perishable items. The supermarket model will only become scaleable in India when most Indians can afford cars, refrigerators and ample storage space, something that appears unlikely any time soon.

Mohammed Zakir
Cambridge, Massachusetts

How to help humanity

SIR – Your review of James Traub's book on Kofi Annan cites the Iraq war, the oil-for-food scandal and sexual abuse by peacekeepers as evidence that the outgoing secretary-general has missed critical opportunities to strengthen the UN and prove himself a strong leader ("Behind the scenes", October 28th). For all its flaws and mistakes, the UN has done much good over the past ten years and it would be a shame to let that go unrecognised. As Dag Hammarskjold famously remarked, "The United Nations was not created to take humanity to heaven, but to save it from hell."

Zaahira Wyne
Fredericksburg, Virginia

Europe's real location

SIR – Kazakhstan's president, Nursultan Nazarbayev, is on the wrong track if, as Charlemagne reports, he thinks his country is geographically more in "Europe" than Turkey and thus has a better claim to join the European Union (October 28th). But this does raise an interesting question about what Europe's geographical boundaries are. Geographically, Cyprus is in Asia, with which it has historic ties stretching back centuries. It only became "European" in 1961 when it was accepted into the Council of Europe and then later joining the EU in 2004.

Legally, a country is defined as European, not by its geography but by its democratic and institutional adherence to common European values, specifically human rights and fundamental freedoms. Europe thus defines and organises itself. Robert Schuman, France's foreign minister and a founding father of the EU's institutions, provided that definition of Europe at the signing of its statutes in May 1949 and today all roads to Europe lie through Strasbourg.

David Heilbron Price
Brussels

No more jobs for the boys

SIR – Your report on the American economy claimed to be mystified by the decline in teenage employment despite the growth in the restaurant industry ("Slow road ahead", October 28th). I suggest that at their next lunch your editors quit poring over statistical tables, lift their heads and look around them. I recently had breakfast at McDonald's and lunch at Red Lobster. Most of the greeters, order-takers, cleaner-uppers, etc, were not teenagers but adults of either Asian or Hispanic extraction. Moreover, these were energetic people, working hard and appearing to like their jobs. Maybe there is something to this immigration thing after all.

Charles Cole
Oakton, Virginia

SIR – The ubiquitous paperboy is no more and has been replaced, more often than not, by middle-aged recent arrivals. The effect of low-skilled immigration on wages, along with the declining value, in real terms, of the minimum wage, have made the decision of young people not to enter the workforce a no-brainer. Unfortunately their extra time is usually spent not on education but on the video games you write of in the same issue ("Playing a different game", October 28th).

Warren Wilczewski
New York

SIR – It is correct to point out that raising America's minimum wage will not significantly decrease poverty because the poor population consists of much more than simply minimum-wage workers ("A blunt instrument", October 28th). However, your solution of an earned-income tax credit (EITC) is also flawed. Just as a minimum-wage hike would not reach jobless individuals, an EITC would also not help the jobless because they have no income. Either of these initiatives could be part of a successful anti-poverty programme, but job creation and training provisions are also necessary. Isolated, non-comprehensive measures will not have much of an impact.

Brian Levy

Athens, Georgia

Inhospitable for Martians

SIR – I agree with your view, in relation to the Stern report on climate change, that governments should act on “the risk of something really catastrophic” (“Stern warning”, November 4th). I propose investing in a space defence system to protect against alien invasion. Like the melting of Greenland's ice sheet, only a minority of scientists perceive this as a threat and the costs of such a defence are enormous, but if aliens were to invade it would also be a disaster.

David Crawley
Hong Kong

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Germany's place in the world

Merkel as a world star

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Germany's chancellor wants to play a bigger role on the world stage. But are Germans ready?

Getty Images

WITH more than 80m people and the world's third-biggest economy, Germany squats like a giant in the centre of Europe. For most of the six decades since the second world war, it has been a giant in chains. The desire to tie it down was one of the chief motives of the German and French politicians who founded what has become the European Union. Memory has added fetters, too. The horrors of the Nazi period have imbued today's Germans with a profound antipathy to war and foreign entanglements.

At the beginning of this decade, however, the giant stirred. Under the chancellorship of Gerhard Schröder, Germany began cautiously to use military power outside its borders, in the Balkans. When America and Britain embarked on their Iraq adventure, Mr Schröder made a dramatic break with the United States, vigorously opposing the war and showing a new readiness to assert Germany's own power and interests. Now a new chancellor, Angela Merkel, has spent a year in office at the head of a grand coalition, the forced marriage of the centre-right Christian Democrats (CDU) and the centre-left Social Democrats (SPD). Next year she will occupy the rotating presidency of both the EU and the G8 rich-country club. Where will she take German foreign policy?

When she took over the chancellery last November, many observers expected her to be a German version of Margaret Thatcher (minus the threatening handbag), and knock the economy back into shape. Instead, she has turned out to be more of a foreign-policy chancellor. To avoid political quicksands, she let visits abroad dominate her first few months. She was more effective in helping to bring about a ceasefire in Lebanon than in putting an end to annoyingly narrow-minded fights about health care and other domestic matters. And next year, she is expected to star, not just because she will lead the EU and the G8, but because so many of the other world leaders are lame ducks while she is just starting out.

In ten years from now, says one of her close advisers, the grand coalition may be remembered not for the disappointments on the home front but for the fact that it has helped to reconcile Germans to the truth that unification and the end of the cold war did not create a peaceful world, but a brutal one full of conflicts, “and that Germany must assume responsibility to solve them.” But if Germans can no longer shield themselves from the harsh realities of world affairs, how they react to this “reality shock” remains an open question.

The change, of course, was not sudden. Germany began assuming a stronger world role once the end of the cold war brought the country not just unification, but full sovereignty. Its foreign policy, much like its welfare state, was obliged to face up to the consequences of globalisation. But whereas the welfare state could not be easily adapted to fit with the way the world was going, Germany's foreign policy turned out

to be far more in tune with the new challenges of an interdependent world. The catastrophe of the second world war, and decades of living with limited sovereignty, taught the Germans the virtues of soft power and multilateralism. Hans-Dietrich Genscher, a long-time former foreign minister, once famously said that Germany had no national interests, because its interests were identical with Europe's interests.

But where Germany long differed from its allies was in the ability and the willingness to send troops abroad. The Bundeswehr, the German armed forces, was set up to defend the homeland against attacks from the east. It would not have been politically possible, until the 1990s, to deploy soldiers in foreign interventions: most Germans were staunchly pacifist. Only in 1994 did the constitutional court rule that German soldiers could be allowed outside the NATO area, and then only if parliament had given its approval.

It took a coalition of Social Democrats and Greens, both with strong pacifist leanings, to send the Bundeswehr into armed combat, thus breaking the post-war taboo. In 1999, Mr Schröder risked a vote of confidence to dispatch fighter planes to take part in NATO's war in Kosovo. Nowadays, Germany is one of the larger providers of peacekeeping troops, with nearly 9,000 men and women spread over a dozen missions that range from Afghanistan to Sudan (see chart).

Mr Schröder reconciled Germans to the use of military power but without compromising the country's belief in non-military intervention. Armed forces are still seen as one instrument only in dealing with a conflict. In northern Afghanistan, for instance, Germany is testing out a new type of provincial reconstruction team (PRT), which truly mixes military and civil groups. The German PRTs are led jointly by a military commander and a diplomat, and the soldiers are complemented by teams of civil servants and aid workers.

Widely, but still safely, spread

German troops on foreign assignments*

Mission	Numbers
Afghanistan, Uzbekistan	2,898
Kosovo	2,875
Lebanon	1,021
Bosnia	847
Congo	754
Horn of Africa	332
Sudan	37
NATO Mediterranean patrol	23
Georgia	11
Other	44
Total	**8,842**

Source: Deutsche Bundeswehr *As of Nov 8th

A new sort of German nationalism

Mr Schröder also introduced another novelty into Germany's post-war foreign policy: a kind of German Gaullism. Foreign policy, he insisted, “is decided in Berlin”, and he vowed to defend Germany's interests. This partly explains his opposition to the war in Iraq, an opposition which helped him to get re-elected in 2002, but badly damaged transatlantic relations. His more nationalist approach led to close friendships with the French and Russian presidents, and also to the pursuit of a permanent seat at the UN Security Council.

As a result, Germany was no longer perceived as a fixed star in the European firmament, let alone stolidly in mid-Atlantic. It was seen to be much freer, prepared to act on its own. Ms Merkel's contribution was to move swiftly to return the perception to what it had been. She has realigned Germany's position, putting some distance between herself and Jacques Chirac, and between herself and Russia's leader, Vladimir Putin, while edging closer to America's president, George Bush.

This effort to reposition Germany has guided her foreign policy. Mr Chirac's frequent hand-kissing notwithstanding, relations with France have cooled significantly. And when Mr Putin visited Germany in October, Ms Merkel did not hesitate to address the murder of a Russian journalist, Anna Politkovskaya. This was in sharp contrast to Mr Schröder who, during his tenure, called Russia's president “a democrat through and through”.

At the same time, she has established an excellent relationship with Mr Bush, though she does not flinch from criticising the United States on such issues as Guantánamo and the CIA “rendition” flights. During her time in the EU presidency, her government would like to start a new transatlantic project. This would be a joint American-EU effort to come up with common standards in such areas as hedge-fund regulation and intellectual property.

An even more important difference between Ms Merkel and her predecessor is her position on EU enlargement, particularly the question of Turkish membership. Mr Schröder was a staunch proponent of Turkish accession, mainly for geopolitical reasons, seeing Turkey as a link between Europe and the Muslim world. Although Ms Merkel wants negotiations to go ahead, she thinks Turkey's relations with the EU should stop short of full membership—a position that is now supported by a large majority of Germans. This could spell trouble within the coalition, since the SPD still wants Turkey inside the union.

The quest to become a permanent member of the Security Council has been quietly abandoned, for now. Instead, Germany is playing an important part in foreign issues where it believes it can make a difference. Witness the negotiations over Iran's nuclear programme, in which Germany's involvement, together with the five permanent council members, is signalled by the shorthand “P5 plus one”.

Germany, says Volker Perthes, director of the German Institute for International and Security Affairs, is now pretty much where it belongs: squarely at the centre. Whether it wants to be or not, the country is a *Mittelmacht*, or middle power. It is not a superpower, able to throw its weight about, but it is in a good position to take responsibility in cases where it can bring something to the table. This is so, for instance, in Central Asia, where Germany is not just the only European country with embassies in all five countries, but has also developed good links with civil society across the region.

It is hardly surprising, then, that Germans, so full of domestic gloom, are relatively happy about their current place in the world. But they are warned by Michael Zürn, dean of the Hertie School of Governance in Berlin, that this is no reason for self-congratulation. In a recent paper, he tries to assess whether Germany is doing enough to live up to its self-image of being “a power of peace”. His sobering conclusion is not exactly, at least compared with other countries.

Hesitant power for peace

A direct comparison of Germany's defence spending (1.4% of GDP) with that of the United States (3.7%) is somewhat unfair: the whole point of Germany's foreign policy has been to avoid putting resources mainly in the military basket. But even if you add together the budgets of the ministries of defence, development and foreign affairs, Germany's record is not stellar. This share of “international policy” in Germany's federal budget has dropped from more than 20% in the early 1990s to 12% last year—not just because of less money for defence but also because there is less for development aid. Other indicators confirm that Germany is only a *Mittelmacht* when it comes to committing resources to development aid.

Moreover, the number of German troops abroad do not tell the full story. The Bundeswehr has been slow to adapt to a world in which conventional war in defence of the homeland is unlikely. Despite 253,000 soldiers and a budget of €24 billion ($28 billion), it has a lot of trouble mustering and equipping its peacekeepers. And these troops have rarely been at the centre of the action: in Afghanistan, they stay in the relatively calm north; in Lebanon, they patrol at sea, not on land.

AFP

They could do with better backing

More important in the long run, argues Mr Zürn, is the degree to which foreign-policy questions play a role in Germany's public debates. Though the coverage of international affairs in leading newspapers and broadcasts has increased, particularly when it comes to matters to do with the EU, domestic issues continue to dominate, even more than they do in other European countries. Politicians seem less and less interested in foreign-policy matters that pay no dividends on election day. Of the 109 new members who entered the Bundestag, Germany's parliament, at last year's election, only one admitted to an interest in foreign policy. Nor does it help that Germany is rather short on foreign-policy experts. “Foreign policy has no lobby of its own,” says Mr Perthes.

Even though the public seems fairly content, at least for the moment, with the way that foreign policy is going, the country's leaders have not yet done enough to ensure that support will continue for the policy of sending troops abroad. In urging the dispatch of troops to Kosovo, Mr Schröder used strong moral imperatives (“Never again Auschwitz”) to convince the public to allow fighter planes to go into combat. It

is hard to follow so emotional an approach with less passionate justifications. There has seldom been any open talk about military dangers. And only low-risk missions are proposed.

There are obvious reasons for this. Pacifism remains deeply rooted. Moreover, parliament's powers in military matters is a German speciality: even a mission composed of two envoys in Ethiopia must be approved and its mandate renewed annually. But what this means is that, although the public now accepts the need for intervention and peacekeeping, the support is not all that solid. Most people see soldiers as little more than armed development-aid workers, who expend goodwill and good works, but do not get harmed. There may well be a backlash, says Josef Janning of the Bertelsmann Foundation, a think-tank, if something really bad happens, such as a busload of soldiers dying while fighting the Taliban.

Fortunately, the Bundeswehr has been lucky so far. Since 1991, 64 German soldiers have been killed, most of them by accident. But this state of affairs may not continue. In Afghanistan, for instance, the north is no longer an oasis of calm and German soldiers are regularly attacked. Germans are also discovering that their soldiers can come home as traumatised war veterans, and sometimes do nasty things in action. Witness the uproar created by pictures of German soldiers in Afghanistan holding up skulls. More to the point, NATO allies are turning up the heat on Germany to let its soldiers fight in Afghanistan's much more dangerous south.

The battlefield is not the only place where the rules of engagement are changing. For Germany, the negotiations with Iran were supposed to be an example of effective multilateralism. But now, with Iran unresponsive, Germany may one day soon have to decide whether it is willing to accept the price of tougher sanctions.

And this summer, Germany found that it, too, is not entirely safe from Islamist terrorism, despite its opposition to the war in Iraq. Two Lebanese students placed bombs on regional trains, though these fortunately failed to explode.

For decades, Germany was happy fighting culture wars over nuclear versus renewable energy, while conveniently forgetting that it was increasingly dependent on Russian gas imports. But a recently leaked memo by the foreign ministry's internal think-tank has triggered a heated debate that is reminiscent of discussions about the Soviet Union during the cold war—and also exposes frictions between the foreign ministry and the chancellery. The leaked paper argues that the EU should strengthen its economic and cultural links with Russia, an approach it calls “growing closer by interweaving” (which explains why some have dubbed it a “new *Ostpolitik*”, given that this was based on the mantra “change through becoming closer”). To critics, this amounts to ignoring both the issue of human rights in Russia, and the danger, for Germany, of energy dependence.

But, at least in the short run, the EU remains the most pressing issue for Germany. Although the government is trying to lower expectations, hopes still run high that Germany can salvage the proposed EU constitution. Yet the presidential election in France next May means that there is not much time, during Germany's six-month presidency, to tackle the issue.

In a sense, this presidency will really begin only on March 25th, when leaders of the EU's member states gather in Berlin for the 50th anniversary of the Treaty of Rome, the union's founding document, and adopt a “Berlin Declaration”. This is supposed to be only a few pages long and drafted in direct talks between governments rather than by the Brussels bureaucracy. The hope is that it will re-launch the union, by stating common values and committing members to a genuine effort on the EU constitution.

Germany will need to be more creative than that if it is to accomplish what Ms Merkel calls “squaring the circle”: tweaking the constitutional treaty to make it more acceptable to critics, notably in France, but without obliging the 15 member states that have already ratified it to do so again. Ms Merkel will consult to find out what members can accept, and when decisions would fit into their political schedule. At the EU summit next June, Germany will present a report that outlines how the constitution might be salvaged until France takes over the presidency in 2008.

Germans are still learning that they have to take over more responsibility

If there is a European leader to find a solution, Ms Merkel may be the one. Among her colleagues, says Gerd Langguth of Bonn University, who has written her biography, she stands out as being extremely rational, wanting to get things done and not making a big fuss about herself. At home, this has become somewhat of a weakness, argues Mr Langguth: she tends to underestimate the importance of emotion in

politics and the need to demonstrate leadership. On the international scene, however, it may be a strength: international issues are mostly about interests and law—and not about calming erratic state premiers from Bavaria or North Rhine-Westphalia.

A successful EU presidency would give her the authority she needs to breathe life into the grand coalition, says Wolfgang Nowak, of the Alfred Herrhausen Society, a think-tank. This would be welcome, for things are not so good at home. Yet, in more than one way, Germany's political system is simply doing what it was built to do after 1945: protect democracy by making it hard to bring about fundamental change. In no other rich country do so many players have a say in how their nation is governed: the state premiers, the coalitions, the constitutional court. Many had hoped that this latest coalition would somehow manage to overcome the “joint-decision-making trap”, bringing the country up to speed with the rest of the world.

In the coalition's first year, it was probably a good thing that it did not. Not trying too hard to cut the budget deficit encouraged the economy to recover nicely. Growth is likely to reach 2.4%, the highest rate in five years. Unemployment is down by nearly 500,000 on a year ago, to some 4.3m people. And, thanks to booming tax revenues, even the budget deficit is likely to fall to its lowest level since the country's unification 16 years ago.

A tough learning process

The real problem is that Germans are continuing to lose faith in their political system—mainly as a result of the bickering within the coalition. Both the CDU and the SPD are hovering around 30% in the polls. Worse, according to a recent survey, a majority of Germans now say, for the first time, that they are no longer satisfied with how their democracy works.

Such a snapshot should not be misread: Germans are not about to ditch democracy. But there is a danger that, unhappy about direction, they may rediscover isolationism. Already, Euroscepticism is on the rise. And two-thirds of Germans now think that their soldiers should not be sent on any new missions. “Germans are still learning that they have to take over more responsibility,” says a top official at the chancellery. “The problem could become that the world will ask us to do too much at this stage of our learning process.” Germany has made great progress at finding its place in the world since unification, but it is not yet over the hump of history.

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Bipartisanship

A new era of co-operation

Nov 16th 2006 | WASHINGTON, DC
From The Economist print edition

Both Congressional Democrats and President George Bush say they will work with each other. That doesn't mean they will

Get article background

LAST week, Americans voted for divided government. Now they want to know how it will work in practice. Will the incoming Democratic majorities in the House of Representatives and the Senate hold the executive to account, or merely obstruct it? Will President George Bush veto every bill the Democrats send his way, or only the bad ones? Will moderate Democrats and Republicans co-operate, or will party discipline trump good sense? None of these questions can be fully answered before January 3rd, when the Democrats formally take control of Congress. But the world will not stop just because America has a lame-duck legislature—this week, for example, saw alarming new revelations about Iran's nuclear programme and the brazen mass kidnapping of education officials in Baghdad.

Both sides say they will work together. You might have thought, during the campaign, that they did not much like each other: Nancy Pelosi, the top House Democrat, called Mr Bush ignorant, incompetent and shallow and Mr Bush described the Democrats' strategy for Iraq as “the terrorists win and America loses.” But as Mr Bush noted last week, people often say unfortunate things during campaigns, and “if you hold grudges in this line of work, you're never going to get anything done.” He called for a “new era of co-operation”.

A whiff of bipartisanship would be nothing new in the Senate, where the minority party can thwart the majority by filibustering (blocking) legislation. But in the House, where a simple majority is enough to pass any bill, the Republicans have ruthlessly excluded Democrats from the law-making process. Dennis Hastert, the outgoing Speaker, brought bills to the floor for a vote only if they had the support of a majority of Republicans. The Democrats might perhaps like to do the same, but since their bills must be signed by Mr Bush, they cannot expect to get far if they do.

In some areas, the potential for co-operation is obvious. Immigration reform (see article) is a good example. Mr Bush's plan—a mix of tougher border controls and more generous provisions for immigrants to work legally and eventually become citizens—was squashed by House Republicans this year. If Ms Pelosi were to reintroduce something like it next year, both Democrats and liberal Republicans would vote for it. But she has given no sign that this touchy issue will be a priority.

Other areas could be trickier still. Carl Levin, the incoming head of the Senate armed services committee, says voters have “clearly and powerfully” demanded a change of course in Iraq. He calls for a “phased redeployment” of American troops in four to six months. Signalling that “our presence is not open-ended,” he says, will nudge Iraqis to make the necessary political compromises to avoid civil war. Mr Bush does not agree, and will resist any attempt by Democrats to beat a hasty retreat. Other Republicans, such as John McCain, argue that Iraq needs more American troops, not fewer. However the debate advances, Iraq will remain largely a presidential responsibility. The new Democratic Senate will zealously grill the administration about the decision to go to war and the mistakes in prosecuting it, but its leaders show no appetite, yet, for obstruction. Mr Bush's nominee to replace Donald Rumsfeld as defence secretary, Robert Gates, is expected to be swiftly confirmed (see article). Harry Reid, the top Democrat in the Senate, explained that the sooner Mr Gates is approved, “the sooner we can get rid of Rumsfeld.”

Making lame ducks sprint

In the last few weeks of the year, Mr Bush is hoping that the still-Republican Congress will pass several bills. Nine crucial spending bills will take up a lot of time, but the president also wants to squeeze in a bill to allow warrantless eavesdropping on suspected terrorists, a free-trade deal with Vietnam and a bill allowing nuclear co-operation with India despite India's refusal to sign the Nuclear Non-Proliferation Treaty. He also wants his ambassador to the United Nations, the controversial John Bolton, confirmed (see article).

Ms Pelosi says she thinks a compromise on eavesdropping is possible, if Mr Bush allows some kind of judicial review. The trade deal with Vietnam failed to pass this week and will die if the Republican Congress cannot pass it before the Democrats take over. The Indian nuclear bill's fate is uncertain. Mr Bolton's nomination looks doomed, though the administration is reportedly toying with letting him carry on as “acting” ambassador.

When the Democrats take charge of the House, Ms Pelosi has promised a rapid succession of reforms, mostly piecemeal and populist. Mr Bush is unlikely to veto bills to raise the minimum wage or to restrict and make more transparent the way lobbyists schmooze lawmakers. He will not like a proposal to allow more federally funded stem-cell research, but Ms Pelosi thinks she can assemble a veto-proof two-thirds majority for it. On taxes, clashes are likely. Mr Bush wants to preserve his broad tax cuts, while the Democrats want to raise taxes on the rich while offering relief for the upper-middle class by adjusting the alternative minimum tax.

This week meanwhile, both parties have been pre-occupied with picking their leaders. Ms Pelosi faces no serious opposition for the speakership, but the race for House majority leader, the number two job, was still wide open. Steny Hoyer, the current number two in the House Democrats' hierarchy, says he has enough votes to win. But Ms Pelosi has backed her friend John Murtha, an impassioned advocate of withdrawal from Iraq.

Mr Murtha argues that this stance helped the Democrats win. His critics fret that his past ethical problems—he was filmed discussing bribes with an FBI agent posing as an Arab sheikh, though he was not indicted—disqualify him. Whether he wins or not, Ms Pelosi's support for him casts doubt on her promise to lead “the most honest, most open and most ethical Congress in history.”

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Immigration

The rusty grenade

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Why immigration didn't play in the mid-terms in the way it was expected to

MANY of the desperate souls who cross America's southern border each year pass through Cochise county in southern Arizona. They drain farmers' water tanks, drop rubbish and, it is said, assault and rob with abandon. Not surprisingly, voters in the mostly Anglophone district were keenly courted this year by Randy Graf, a Republican would-be-congressman who promised to evict illegal immigrants and build a fence to keep others out. On November 7th though, the people of Cochise rejected him in favour of his Democratic opponent.

AP

The soft underbelly

Illegal immigration was expected to be a burning issue in the mid-term elections. It was, though not in the way that many Republicans hoped. J.D. Hayworth, author of “Whatever it Takes”, a scorching tome on the matter, was ousted by voters from his sprawling district east of Phoenix. In Indiana, the uncompromising head of the congressional subcommittee on immigration lost his seat. “It was said that illegal immigration was going to be our magic-carpet ride to power,” says Jeff Flake, a moderate Arizona Republican. “It turned out to be quite the opposite.”

The fact that nativist appeals failed to rouse voters does not mean that the people of Arizona are sanguine about illegal immigration. Nor does it suggest the issue is politically inert, either in the state or the country. The mid-term elections showed illegal immigration to be not so much a magic carpet as a rusty grenade—explosive and tricky to handle.

Mexicans flock to Arizona because some routes through California and Texas have been closed. They stay for the jobs. Migration from other parts of America means that the state's population is growing at the second-fastest rate in America. A construction boom has sucked in workers and transformed Arizona's towns. In 1980, Phoenix was one of the more homogenous cities in America, with few blacks and Hispanics accounting for just 15% of its population. By 2005, it was 42% Hispanic.

The influx—or, as Russell Pearce, a Republican state legislator, calls it, the invasion—of illicit migrants rankles. On November 7th slightly more Arizonans told pollsters for CNN that illegal immigration was “extremely important” than said the same of terrorism, the Iraq war or the economy. They overwhelmingly supported ballot initiatives that would make English the state's official language, deny bail to illegal immigrants who commit serious crimes and cut them off from education spending.

Why then did they reject Republican candidates who supported such measures? The defeated Mr Graf believes that congressional scandals and the Iraq war drowned out his message on illegal immigration. He is probably right, but it is also likely that his appeal was off-key: one of his ads closed with a woman stroking her pregnant belly and imploring voters to support Mr Graf “for the safety of our children and all Americans”.

Such crude appeals, combined with tough talk from congressional Republicans, turned off many Hispanic voters. That is more difficult than it might sound. American-born Hispanics tend to resent illegal immigrants for the same reason others do—but they also have reasons of their own. New arrivals tend to settle in their neighbourhoods, crowding their children's schools and crashing, uninsured, into their cars. Edmundo Hidalgo of Chicanos Por La Causa, a pressure group, says Hispanics are often keen on laws intended to curb their fellows' most offensive behaviour, since they lose most if Hispanics become a pariah group. Last week, though, Hispanic voters plumped for Democratic candidates by an overwhelming margin—seven to three, up from six to four in the 2004 presidential election.

The other reason why tough talk from Republicans failed to motivate voters has to do with their opponents' tactics. In Arizona, no serious candidate ran a pro-immigrant campaign. Democrats opposed an amnesty for illegal immigrants. They asserted that the border must be fixed, and blamed Republican-controlled Washington for failing to do so. Then they stuck the knife in: they fully agreed with George Bush and John McCain, Arizona's popular senator, that immigration reform must provide a route out of the shadows for illegal workers. Some of their Republican opponents, they pointed out, did not, which is why Mr Bush's proposals came to nothing last year.

By diverting fury over illegal immigration into frustration at Republican division and incompetence, the Democrats bought themselves a pass to Washington. It expires soon. And, while the Democratic capture of Congress has removed the biggest roadblock to reform, new obstacles have emerged. Not the least are the unions, which dislike the idea of allowing people into the country to work temporarily. As some Republicans note with glee, any failure to deal with illegal immigration in the next two years is likely to hurt the other side at the polls.

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Medals

The undecorated

Nov 16th 2006 | WASHINGTON, DC
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Serving at high risk, and no medals to show for it

IN APRIL 2004, an Iraqi insurgent fighting hand-to-hand with American marines pulled a grenade. Corporal Jason Dunham covered the grenade with a helmet and the helmet with his body. He sustained severe injuries and died eight days later. “If it was not for him, none of us would be here,” said Kelly Miller, one of several marines who survived the blast.

On November 10th, George Bush announced that Corporal Dunham would receive the Medal of Honour, America's highest military award. It was the 231st birthday of the Marine Corps, and would have been Dunham's 25th. He is only the second combatant of the Iraq war to be recognised with the medal. Army sergeant Paul Ray Smith won one in 2005, also posthumously.

Though most people have little idea of the relative prestige of various medals, veterans take awards for valour seriously and have noticed that comparatively few of the top ones have been issued recently. Anyone on active duty since the September 11th 2001 attacks can get the National Defence Service medal. And in 2003, George Bush authorised the Global War on Terror Service Medal. Medals that specifically reward heroics are much harder to come by. More than 21,000 veterans won coveted Silver Stars in Vietnam. Only a few hundred servicemen have received the same in Iraq and Afghanistan.

The scarcity of medals has also been blamed for the current shortage of American heroes. Only two soldiers, Jessica Lynch and Pat Tillman, have become household names during the course of the war. Both served with honour but without much chance for heroics. Ms Lynch was injured and captured by Iraqi forces, and Tillman was killed by friendly fire. If the services gave more medals, the bravery of the troops might be more widely publicised.

Before the war on terror, no one complained that medals were too hard to come by. If anything, the military was accused of giving out too many. In 2003, army officials warned field commanders to save their top honours for soldiers “who truly distinguish themselves”. And just before the fifth anniversary of the September 11th attacks, the Pentagon announced that it would take a look at its awards process. The review will take several more months to complete. In the meantime, valour will have to remain its own reward.

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Defence

The anti-Don

Nov 16th 2006 | WASHINGTON, DC
From The Economist print edition

The new secretary of defence can get a long way by not being his predecessor

THERE is nothing like taking over a job from a universal bogeyman. Robert Gates (pictured below, right) is winning praise from almost everyone for the simple reason that he is not Donald Rumsfeld.

He listens while Mr Rumsfeld lectures, we are told. He is a consensus-builder, Mr Rumsfeld a consensus-breaker. And above all he is a protégé of George Bush senior: the closest thing in Washington to being an anointed Wise Man.

AP

Not such a hard act to follow

There is some truth in the last point. Messrs Rumsfeld and Bush had a decades-old quarrel (George Bush senior apparently blamed Mr Rumsfeld for edging him out of the limelight in the 1970s). Mr Gates was a member of the senior Bush's inner circle—first as his deputy national security adviser and then as director of the CIA. He has long-standing good relations with such veterans as Condoleezza Rice, Brent Scowcroft and Stephen Hadley. He had dinner with Mr Bush senior and his wife just a few days before he was appointed to his new job.

The idea that Mr Bush senior's realist cohorts—not just Mr Gates but also James Baker—are riding in to rescue the wayward son is over-done. Mr Bush's first administration was full of people who were close to his father—from Dick Cheney to Colin Powell to Ms Rice and Mr Hadley. Talented Republicans have a habit of popping up in successive Republican administrations.

Nor is Mr Gates a pure-bred “realist”. He has tilted towards the “realist” side when it comes to the war on terror (in 1998 he penned an article in which he warned that violence only begets more violence). But he was also a hawk on the Soviet Union who warned against doing business with Mikhail Gorbachev.

Mr Gates's biggest advantage lies not so much in his ideology (which has a born bureaucrat's flexibility) but in his status as a newcomer to a floundering administration. He has no particular policy legacy to defend. He can bring a fresh perspective to problems. And he can tailor his ideas as the situation requires.

Mr Gates is particularly well positioned when it comes to rebuilding the bridges that Mr Rumsfeld so happily dynamited—between the Pentagon's civilian and military staffs and between the Pentagon and other power centres. Mr Gates, unlike his predecessor, works well with the secretary of state. He is also, as a former CIA head, on record as opposing Mr Rumsfeld's drive to expand the Pentagon's intelligence empire. This could help to put an end to at least some of the turf-wars that have made this one of the most dysfunctional administrations in recent times.

He has a bit less freedom, though, on policy. Mr Gates's membership of the much-heralded Iraq Study Group means that he will have a vested interest in getting the report accepted and acted on. His co-chairing in 2004 of an independent task force on Iran, which recommended engagement rather than confrontation, has tipped his hand on a key issue. But his instincts are in tune with popular sentiment. And he knows that he comes to office with a single overriding objective—to do something about the mess in Iraq.

Mr Gates has plenty of skeletons in his closet. He was a career Soviet analyst who failed to predict the Soviet Union's collapse. He was closely involved in the Iran-Contra affair (and withdrew his nomination

for the directorship of the CIA the first time he was up for it in 1987 under pressure from Congress). But does any of that matter so long as you are not named Rumsfeld? The betting is that this time Mr Gates will sail through. Rescuing the president, though, is another matter.

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Public-sector pensions

The known unknowns

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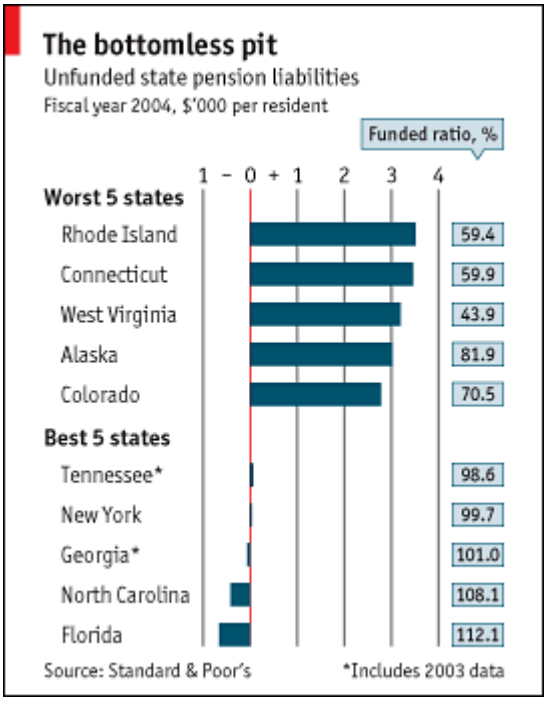
New rules will force state governments to come clean about retirement costs



THE promises that politicians make to campaign donors and taxpayers are often good only till the next election. By contrast, the commitments they make to public employees—such as firemen, teachers and bureaucrats—are for life. America's state and local governments are struggling to meet pension and health-care obligations to their retired workers. So many of those governments are dreading a new accounting rule that will make them report clearly on the size of the problem.

The new rule, issued by the Government Accounting Standards Board (GASB) in 2004, goes into effect on December 15th. It will require public-sector employers to treat their health-care promises to workers the same way they already handle their pension obligations: by reporting on the total size of their future commitment, instead of just this year's cost.

The states are having a hard enough time meeting their pension promises. Falling share prices earlier this decade ate into their pension assets, while generous pledges to increasingly long-lived employees drove up liabilities. By 2004, assets in the average state's pension fund were enough to cover only 84% of its accrued pension liabilities, according to Standard & Poor's (S&P), a rating agency.

West Virginia has the biggest gap as a percentage; its pension assets are less than half its liabilities. But taxpayers in Rhode Island and Connecticut face the biggest burdens: roughly $3,500 of unfunded pension liabilities per citizen (see chart).

For the 50 states as a group, S&P reckons, the 16% shortfall is equal to $284 billion, almost as large again as their combined general-spending debt. Many American cities are in a similar bind. Of the 20 biggest, Philadelphia has the largest shortfall, with funding for only 53% of its pension liabilities.

As hard as it will be for state and local governments to meet public employees' pension costs, paying for their retirees' health care is an even bigger challenge thanks to rapidly rising costs. California, for example, faces $49 billion in unfunded pension liabilities, but believes that its health-care shortfall is another $70 billion. Maryland estimates that its unfunded health-care costs top $20 billion. That is $300,000 per public worker, nearly eight times its pension shortfall.

Chris Edwards and Jagadeesh Gokhale of the Cato Institute, a libertarian think-tank, reckon that America's state and local governments face a total shortfall in their health-care plans of $1.4 trillion. They arrive at that staggering sum by extrapolating from 16 states and 11 local government employers that have tried to gauge their health-care liabilities, which amount to roughly $135,000 per state or local employee. Even if Messrs Edwards and Gokhale have overstated the problem, many experts agree that the health-care shortfall is much bigger than the pension gap.

Fortunately for public employers, they probably have more leeway than with pensions to tackle the problem. Courts in many states have issued rulings that make it hard for those governments to break a pension promise to their employees. Health-care plans are less sacrosanct. The sooner public employers

start breaking those vows the better. The new accounting rule, though dreaded by some officials, should help—by shedding some much needed light on the problem.

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Health care

Carmakers' woes

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Lobbies block reform

HYBRID engines are all the rage, but attacks are mounting on America's hybrid health-care system. The soaring costs are met through government entitlements for some, employer-paid schemes for others, and expensive insurance plans that only some of the people caught in the gap can afford. Many Americans hate this system. The most prominent bunch to complain about it this week were the heads of the country's “big three” car companies (General Motors, Ford and DaimlerChrysler), who visited George Bush in the White House as he prepared to deal with the new Democratic majority in Congress.

The struggling carmakers also had other complaints for the president, of course. They think that trade rules are unfair and that the Japanese government is manipulating the yen. One of the car bosses' main complaints, however, is that health-care costs make it hard for them to compete (they pay more for health care now than for steel). In this, they say, their interests are aligned with many other employers, and with America as a whole. Although that is true to some extent, health-care politics is also driven by competing lobbies with little interest in comprehensive solutions.

The Democrats, newly victorious, complain that Mr Bush and the Republicans care only about the profits of insurers and drugs companies. A prominent pledge at Democratic campaign rallies this autumn was to force drugs firms to negotiate prices with the government. Mr Bush signed into law a prescription-drug subsidy for seniors that does not allow this sort of bargaining. The Democrats also loathe big companies—especially Wal-Mart, a giant retailer—that do not give their employees comprehensive health care.

But Democrats, too, have their own special interests—such as unions. And the unions at America's carmakers have generous contracts that do not hold health-care costs in check. Then there is the growing Service Employees International Union (SEIU), which drums up support for Democrats while leading the charge against Wal-Mart. Half of the SEIU's 1.85m members work in health care, as nurses, hospital employees and so forth. They, too, want secure, high-paying jobs; hardly a formula for holding down costs.

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About sponsorship

Nuclear power and the mountain West

The uranium rush

Nov 16th 2006 | CASPER, WYOMING AND MOAB, UTAH
From The Economist print edition

Prospectors flock west

“HELL, I'm 80,” says Bob O'Dell. “They dug me up and put me to work.” Mr O'Dell is a geologist, based in Casper, Wyoming and employed by Energy Metals, a Canadian uranium company. He should indeed be snoozing on a porch in well-earned retirement. But the uranium market is so hot just now that he—along with many other geologists and metallurgists—has been lured back to work.

The price of uranium oxide, the raw feedstock required for nuclear reactors, was in the doldrums for nearly a generation. Most American uranium mines closed, battered by low demand, a glut of imports from Russia's decommissioned atomic weapons and the discovery of higher-grade ores elsewhere. America fell from being the world's leading uranium producer to eighth, behind Namibia, Niger and Uzbekistan. Experts retired or left for better prospects, mostly in northern Saskatchewan or Australia. As recently as 2001, uranium oxide traded at $7.10 a pound, or $3.22 a kilogram.

No more. Thanks to the spiralling global demand for power, the price or uranium has been climbing steadily ever since 2001: it was trading at $62 this week. Uranium companies are scrambling to find qualified workers and few places match the Rockies.

For some years, in fact, Rocky Mountain producers have been rebuilding their industry. They now mostly extract uranium by in-situ leaching (ISL), which pumps alkali or a weak sulphuric acid solution into an isolated, ore-bearing stratum and recovers the mineral in suspension. The process is not completely free of contamination hazards, but it avoids the problems that have plagued open-pit or underground mines for decades, especially that posed by radioactive tailings.

Yet high demand has also re-kindled enthusiasm for the old ways. In July, a South African/Canadian firm called SRX Uranium One swooped into Wyoming and Utah and bought two of the four remaining uranium-processing mills left in the country, both currently mothballed. They also acquired mining rights and plan to extract ore by digging it out.

The boss of SRX, Neil Froneman, seems undeterred by the costs and obstacles of conventional mining. Because ISL can operate only under certain geological conditions involving isolated aquifers, he says, underground mining is bound to make a comeback.

Locals feel cautious. Uranium's influence has been spotty but powerful in the rural West. One of the last American boomtowns was Jeffery City, 100 miles (160 km) from Casper and close to one of SRX's new acquisitions. It ran on uranium. During the last jag of high prices in the mid-1970s it supported nearly

5,000 people. Now it has 50, the school is shut and locals doubt the town will ever pull itself up again. Moab, Utah, also seems suspicious of a new boom. Once known as “The Uranium Capital of the World,” it is still dealing with radioactive mill-tailings from the last boom: that has cost the government some $500m.

Still, though SRX's new property, Shootaring, is 160 miles (260 km) from Moab, such distances mean little in the West. Sooner or later Grand County will feel the development. The Utah Geological Survey says that more than 5,000 uranium claims were filed in 2005. More octogenarians could soon join Mr O'Dell.

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Purity balls

In praise of chastity

Nov 16th 2006 | VAN WERT, OHIO
From The Economist print edition

Staving off the evils of sex before marriage

"YOU'RE here to celebrate the idea of purity," intones the pastor solemnly. "You find people in the sack all the time in the movies...But God has a better plan."

Some 40 couples showed up at a country club in the tiny Ohio town of Van Wert on November 11th—not boyfriend and girlfriend but fathers and their school-age daughters, several as young as 10, dressed up in glittery gowns and heels.

After the pastor finishes, fathers and daughters sign pledges to help keep the girl chaste before marriage. Daughters agree to "remain sexually pure until the day I give myself as a wedding gift to my husband." Then the father gives the daughter a ring, to be worn on her fourth finger until it is replaced by a wedding band. Hugs ensue, then a prayer, and then fathers and daughters take to the floor to the strains of "Have I Told You Lately That I Love You?"

Purity balls are one of the newest ways that Christians are trying to keep their children chaste and free of sexually-transmitted diseases. The first started seven years ago in Colorado Springs, a city that is home to the lately disgraced Reverend Ted Haggard. That event is now held at a five-star hotel. This month over 200 people attended.

The concept is spreading around the country. Van Wert got its ball after the pastor and his wife moved from Albuquerque, where they had run another such event. The Van Wert ball is now in its second year, and has inspired two other nearby towns to begin their own. In Colorado Springs, Lisa Wilson, the ball organiser, says she has sent information packs to groups in 21 states and four countries—New Zealand, Sweden, France and Canada. Sponsors, including Wal-Mart and McDonald's in Van Wert, sometimes help pick up the tab for the events.

But what about the boys? Surely they bear at least half of the blame for the scourge of pre-marital sex? In Colorado Springs, Ms Wilson and her husband have created a private "manhood celebration" for their 12-year-old son. He is handed an engraved sword and urged to "grow into the weight of manhood", which includes purity. In Van Wert, ball-goers agree that there should be an event for the boys. Which, if indoctrination of the girls works, seems a reasonable idea. Otherwise the chaste will constantly be chased.

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Lexington

And they're off!

Nov 16th 2006
From The Economist print edition

The real election campaign gets under way

THE mid-term elections may have turned Capitol Hill upside down. But when it comes to the race for the White House they have reinvigorated the old order. Before the mid-terms the two front-runners—Hillary Clinton and John McCain—looked as if they might be vulnerable to challenges. Now they are further ahead than ever.

The mid-term elections gave both of them a chance to demonstrate their bulging political muscles. Mrs Clinton raised more money than any other congressional candidate—around $50m—despite the fact that she did not face any serious opposition. She starred in 131 events in 57 cities. And she lavished resources on her fellow New York Democrats—making some 45 appearances with her fellow New Yorker politicians and donating $300,000 to the state party. John McCain was likewise a ubiquitous figure on the campaign trail despite not running for re-election. He raised $10.5m for Republican candidates and appeared at 346 rallies, flying 137,747 miles in the process. Mr McCain proved to be a much more popular figure than the president. Charlie Crist, Florida's new governor, pointedly chose to skip a rally with the Bush brothers in order to spend the day with Mr McCain.

Muscle was only the start of it. Mrs Clinton did a lot to discredit the most damaging charge against her—that she is too polarising to win the presidency. She increased her vote from 55% in 2000 to 67%. And she won over lots of conservative voters who had shunned her in 2000: her share in rural upstate New York increased from 48% to 61% and among independents from 46% to 64%. She even won the votes of 20% of Republicans and 28% of conservatives, and came top of the poll in all but four of New York's 62 counties compared with 15 last time.

This formidable performance discredited a second charge against her—that her move to the centre has alienated the “Democratic wing of the Democratic Party”. But the people who have been berating her for selling out—the “netroots”—have made fools of themselves by backing Ned Lamont over Joseph Lieberman. More traditional liberal interest groups continue to back her quite happily (and vice versa: on November 14th she attended a bipartisan “women in power workshop” in the afternoon and the country's first “ethnic media awards” in the evening). Mrs Clinton may go into the 2008 election cycle enjoying the best of both worlds—the enmity of both the deranged left and the demented right.

Mrs Clinton also demonstrated—if any demonstration was needed—that she has the skills for the big time. She exuded a sense of icy competence—all focus and organisation. And she performed a clever double-act with her husband. Bill Clinton proved that he can work up the Democratic faithful without removing the spotlight from his wife. He made over 100 campaign stops in more than 30 states; he also summed up the Republican's problems in a neat phrase that also advertised his wife's virtues—“they can't run anything right”.

The Arizona man

John McCain had an even better mid-term than Mrs Clinton—proving that his brand of Republicanism is what the party needs if it is to avoid self-destruction. Mr McCain has spent the past six years or so warning his fellow Republican lawmakers about the dangers of institutional corruption and warring with “movement conservatives” on the grounds that he thinks that they are in danger of alienating mainstream opinion. On November 7th the voters proved him right on both points. They voted against Washington's institutionalised corruption (41% listed corruption as one of their biggest concerns); they also kicked out hardline conservatives such as Rick Santorum and Jim Talent. This not only weakened Mr McCain's critics in the “movement”; it also hobbled many of his direct presidential rivals, such as George Allen, who lost his senate race, and Mitt Romney, who made the possibly fatal mistake of too obviously throwing in his lot with the religious right.

Mr McCain also brings something positive to the table. One reason the congressional Republicans ran out of energy is that they abandoned Newt Gingrich's reform agenda without replacing it with another one. Mr McCain is an exception. He has plenty of ideas about fixing things that worry ordinary Americans—from campaign finance to immigration to the treatment of prisoners. He has also proved that he is willing to work with fellow reformers from across the aisle, producing some impressive bipartisan legislation on big subjects.

This is not to say that either candidate will find the 2008 primary a cake-walk: presidential primaries never are. They are both prominent supporters of a war that the American people have overwhelmingly rejected. Mrs Clinton has made a lot of noise about mismanagement—hardly a controversial position—but that cannot obscure the fact that she supported a war that many in her party thought was doomed from the start. Mr McCain has doubled his bet by calling for more troops to be sent to Iraq—a move that may increase his appeal to the party faithful while at the same time making him look dangerously out of touch to the general electorate.

They both have weaknesses beyond their control. Mrs Clinton has Mr Clinton and his roving eye. Mr McCain has the fact that he is already 70 (Reagan was 69 when he became president). And they both have rivals who can replace them if they stumble—Barack Obama and Rudy Giuliani. Mr Obama is much more exciting than Mrs Clinton: a charismatic black man who embodies the Democratic Party's self-image as a rainbow party. Mr Giuliani has many of Mr McCain's strengths: a tough guy who fixed New York's crime problem and survived a trial by fire. But 2006 was nevertheless a very good election season for both of them. McCain versus Clinton is upon us already.

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Multiculturalism in Canada

One nation or many?

Nov 16th 2006 | OTTAWA
From The Economist print edition

First Light

Canadians continue to believe in diversity and tolerance. But it is becoming harder

OVER a long and painful history the Ismaili Muslim sect has been dispersed, at times forcibly, to 25 countries across the world. So when their spiritual leader, the Aga Khan, announced last month that he had chosen Ottawa as the site for his new research centre on pluralism, it was widely seen as a particularly powerful endorsement of Canada's tolerant multiculturalism. But his comments came as this approach, enshrined in law and seen by many Canadians as part of their national identity, is coming under unprecedented public criticism.

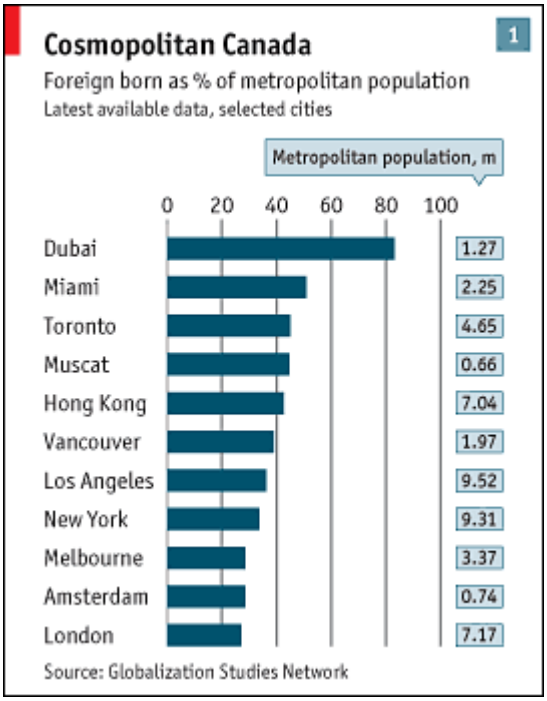
In recent weeks, the debate in Britain over the wearing of the *niqab* or face veil has crossed the north Atlantic to Canada. It came on the heels of claims that the leaders of the large Indo-Canadian population in British Columbia were turning a blind eye to widespread domestic violence. Last year saw an acrimonious dispute in Ontario over whether Muslims could use Islamic *sharia* courts to settle family disputes. (The provincial government eventually decided that they could not.)

In themselves, fights over cultural practices and symbols are nothing new in Canada. Sikhs went to the Supreme Court to win the right for uniformed policemen to wear turbans and students to wear ceremonial daggers known as kirpans. What is new about the latest arguments is an underlying tension between some cultural practices of recent immigrants and the mainstream values of Canadian liberal democracy, such as sex equality.

This comes as a small minority of Muslim immigrants seek to emphasise their separation from, and even hostility to, the wider society. In June 17 Canadian Muslims were arrested on charges of plotting terrorist attacks on targets including the national Parliament. “Muslims are the first group to seriously challenge our notions of multiculturalism and tolerance,” says Neil Bissoondath, a writer on the subject.

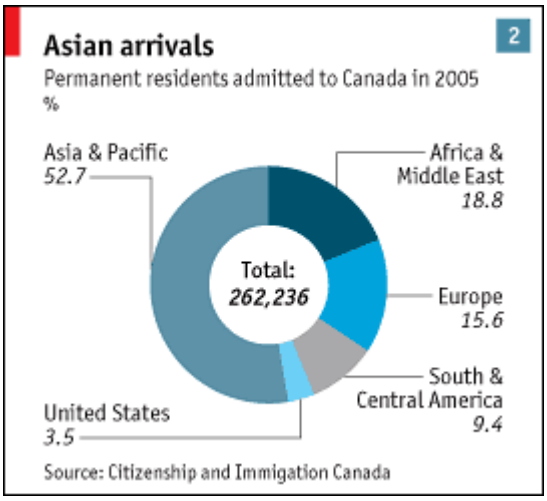
Similar debates have raged in Europe. Two things give them a different edge in Canada. First, even more than the United States, Canada is nowadays a nation of immigrants (see chart 1). Immigration is both increasing and increasingly non-European (see chart 2). Second, from its birth as a self-governing nation in 1867 Canada was a multicultural mixture of British and French settlers and the indigenous people they

called Indians. A century later, this was officially recognised. In 1971 Pierre Trudeau, a Liberal prime minister, declared Canada bilingual and multicultural. The Multiculturalism Act of 1988 replaced the previous policy of assimilation with one of acceptance of diversity.



Multiculturalism has since sunk deep roots in government, reflected in everything from broadcasting to education policy. It has itself become a basic Canadian value. Polls show that a majority support continued immigration and do not want it limited to whites. Almost half believe that immigrants should be free to maintain their cultural and religious practices. But a poll published this week reflected the new disquiet: when asked whether those practices should be tolerated if they infringe women's rights, a large majority said No. Some feminists counter that Canada tolerates other practices that they see as demeaning, such as cosmetic surgery.

One school of thought says that it is time to set firmer rules for what is expected of citizens and to define more clearly what it means to be Canadian. Adherents to this view gleefully seized on a comment by Yann Martel, a novelist, that “Canada is one of the greatest hotels on earth—it welcomes everyone from everywhere.” (Mr Martel claims that he was misunderstood.)



But most commentators still subscribe to multiculturalism as not just a worthwhile aspiration but as the only way of holding Canada together. To preserve it, some trust in muddle-through. When another writer, Michael Ignatieff, who is standing for the vacant leadership of the opposition Liberals, said he favoured recognising Quebec as a “nation”, he was roundly abused, and not just by those who favour a stronger Canadian identity. Better to leave well alone rather than going through the wrenching process of reopening constitutional debates, his detractors said. “Canada is a country that works better in practice than in theory,” said Stéphane Dion (echoing a national cliché), one of Mr Ignatieff's rivals for the leadership and himself a Quebecker.

Others worry that laissez-faire is a recipe for rising tension. They say there is no alternative but to negotiate solutions to cultural clashes, new or old. Rudyard Griffiths of the Dominion Institute, a think-tank concerned with Canadian identity, points to a long history of finding ways to accommodate seemingly intractable differences of language, culture and religion, such as those between English and French speakers or Catholics and Protestants.

Some of the new disputes will doubtless be resolved in the courts. Politicians, who until a few years ago were happy to talk up multiculturalism, have mainly fallen silent. There have been a few exceptions. Dalton McGuinty, the premier of Ontario, said of the *niqab* debate that women were free to do as they pleased. Stephen Harper, the Conservative prime minister, invited the Aga Khan to dinner. His government is helping to set up the new pluralism centre. Officially, then, Canada still stands squarely behind multiculturalism. But the silences are eloquent.

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Colombia

Thugs and politics

Nov 16th 2006 | SAN ONOFRE
From The Economist print edition

Investigating a reign of terror

THE paint still looks fresh on the signs urging voters of the small town of San Onofre to re-elect Álvaro García to Colombia's Senate and Erik Morris to its Chamber of Representatives. At an election last March the voters of the northern department of Sucre did as they were urged. But now both men and another senator from Sucre have been charged by the country's Supreme Court with financing right-wing paramilitary groups who used terror to cow the population. Five other local politicians face investigation. Mr García, who has yet to surrender to police, faces additional charges of helping to plan the killing of 12 people in nearby Macayepo in 2000, and of murdering an election official.

All three are members of political parties that support Colombia's president, Álvaro Uribe. The charges are an embarrassment to Mr Uribe, who began a second term in August. Some Colombians think that they just might mark a turning point in a controversial peace process that has seen 31,000 paramilitaries demobilise and hand in their guns without any serious investigation of their crimes. The paramilitaries were originally formed by cattle ranchers in the 1980s. Many became involved in drug trafficking and extortion.

The charges stem from the seizure by police earlier this year of a laptop computer belonging to a senior paramilitary leader. The computer's files included financial accounts and audio recordings of meetings with politicians in Sucre, whose purpose was to ensure the election of the militia's favoured candidates. The files also carried evidence of schemes through which the paramilitaries stole public money intended for health services.

For people in Sucre, in the cattle-raising tropical lowlands of the Caribbean coast, these revelations do not come as a surprise. The department was the site of several brutal massacres of villagers whom the gunmen held to be sympathisers of left-wing guerrillas. Many of the charges against the politicians had been filed five years ago but had been buried in the prosecutor's office.

The government has welcomed the charges. Carlos Holguín, the interior minister, said they were a “great step” towards learning the truth about paramilitary domination of large swathes of the country. But does the government, or the many landowners who supported the paramilitaries, want to know the whole truth?

José Miguel Vivanco of Human Rights Watch, a New York-based group, points out that the government has yet to develop any plan to require the paramilitaries to dismantle their businesses and political networks. “These criminal mafias need to be treated as such,” he says. Among other things, that would

mean giving more resources to the public prosecutor's office.

There is no reason to believe that Mr Uribe will be directly implicated in the Sucre scandal. But if investigations into the paramilitaries' political influence go wider, with more legislators facing charges, they could cause difficulties for the president.

In San Onofre some residents fear reprisals. Árnol Gómez, the leader of a victims' association, worries that his group may become a target of violence for having helped investigators look into paramilitary crimes. He says that several members of his organisation are already on a hit list circulating in the town. “We are happy and at the same time scared,” he admits.

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Guatemala

Impunity rules

Nov 16th 2006 | GUATEMALA CITY
From The Economist print edition

The gruesome cost of a failure to reform

THE morgue in Guatemala's capital is a busy place. A dozen or more bodies come in every day. The roll call of violent death is recorded in thick stacks of binders that line the wall containing autopsy reports. The smell of formaldehyde seeps out into the nearby hospital and cemetery.

Guatemala has long had one of the world's highest murder rates. An American-organised coup which overthrew a democratic government in 1954 led eventually to more than three decades of civil war between the army and left-wing guerrillas which ended only in 1996. This claimed perhaps 200,000 lives, most of them Mayan Indians killed by the army. Since the war's legacy included many guns and many unemployed former combatants, violence continued. The recent rise of the *maras*, an international network of youth gangs, has added to the mayhem.

AP

An unending wait for justice

In a disturbing recent twist, increasing numbers of women are being killed. According to the police, 624 women were murdered last year, up from 213 in 2000; the figure this year is likely to be even higher. Though still accounting for only 10% of homicides, the killings of women have been marked by gruesome brutality. In more than 90% of cases, the victims suffered sexual abuse prior to death. According to Sobrevivientes, a women's rights organisation, only five of 1,897 murders of women between 2001 and 2005 have been resolved in the courts.

Violence against women is just one aspect of a wider pattern of lawlessness and impunity. There were hopes that this might change when Oscar Berger, a conservative democrat, was elected president in 2003. His coalition included Rigoberta Menchú, an indigenous leader; his government contains respected independents, such as Eduardo Stein, the vice-president, and Gert Rosenthal, the foreign minister.

But Mr Berger, a rich industrialist, has failed to persuade Guatemala's reactionary oligarchies to support needed reforms. These start with tax: the state survives on revenues of less than 10% of GDP. This means that police, prosecutors and courts are all under-funded and overworked. The police comprise just 20,000 officers for a country of 13m people; only 3,000 are on duty at any one time. By contrast, unregulated private security firms employ perhaps 100,000 people. Neighbouring El Salvador, with half the population, has twice as many prosecutors.

Mr Berger has called out the army to patrol jointly with the police. Given the army's repressive history, and that it has never been held to account for its actions, human-rights groups are nervous. Amnesty International reports that killings by the security forces have increased and says a “wave of attacks” against defenders of human rights is under way.

Frank La Rue, who heads a presidential commission on human rights, acknowledges the gravity of the situation. He says that the government will soon send Congress a bill to create a new task-force to tackle organised crime. The UN would help the task-force.

The government's critics also point to the lack of any effort to reform land tenure in a country in which 1.5% of farmers own 62.5% of farmland. They say that police have used unnecessary violence to evict squatters and tenant farmers. Houses and crops have been burned, peasants beaten and no provision made to provide the evicted with new housing.

Ten years after the signing of the peace accords that ended the war, many people say that the country does not feel much more secure. In a year's time, Guatemala will hold a general election. The country urgently needs new political leadership and a change of direction.

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Argentina

The ayatollah of the street

Nov 16th 2006 | BUENOS AIRES
From The Economist print edition

The president fires a troublesome aide

WHEN he became Argentina's president in 2003, Néstor Kirchner inherited the problem of how to deal with the *piqueteros*—a large, fractious and rowdy movement of unemployed protesters formed in the depths of the country's economic collapse of 2001-02. His solution was to shun some of the movement's leaders while co-opting others for his own ends. In February he even named one of them, Luis D'Elía, as his housing secretary, in charge of a budget of $90m. That always looked an accident waiting to happen. This week Mr D'Elía was summarily fired.

In August he had organised an invasion of a large rural estate owned by Douglas Tompkins, an American conservationist, calling for its expropriation and conversion to a national park. He organised a counter-demonstration to a popular march against crime because it was backed by the opposition. Before he joined the government, his followers had trashed a police station. None of this prompted a presidential rebuke.

NA

The unacceptable face of Kirchnerismo

But this month Mr D'Elía went too far. On November 9th an Argentine judge issued a warrant for the arrest of Akbar Hashemi Rafsanjani, a former president of Iran, and eight other former Iranian officials on charges of helping to plan the bombing of a Jewish community centre in Buenos Aires in 1994 that killed 85 people. Mr Kirchner had previously told prosecutors that he would support such a decision.

Whatever the merits of the case against Mr Rafsanjani, the warrant from a judiciary not famous for its independence was widely seen as an attempt to ingratiate Argentina with the United States and to edge away from Hugo Chávez, Venezuela's leftist president, who has forged a close alliance with Iran. Mr D'Elía, who is a staunch supporter of Mr Chávez, went to the Iranian Embassy in Buenos Aires and read out a statement decrying the warrant as facilitating “an American-Israeli military aggression against the Islamic republic”.

Mr Kirchner, travelling in his native Patagonia, was said to have been outraged at this insubordination and ordered Mr D'Elía's sacking. Despite this, the former housing secretary this week reiterated his unswerving loyalty to the president. But from now on such support is unlikely to come cheaply.

The president is expected to seek a second term at an election next October. By blocking a road to demand more welfare payments, Mr D'Elía can place him in a bind. Mr Kirchner has been loth to use the police to clear roadblocks, for fear of losing support on the left. But as the economy recovers, the middle class now worries more about official disdain for law and order. Mr D'Elía was a problem inside the government and will probably remain one outside it.

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Correction: Nicaragua

Nov 16th 2006
From The Economist print edition

In some copies, our leader last week on Nicaragua (see article) omitted a crucial word: not. The relevant sentence should have read, “Enlightened government of the left, combining market economics with social policy, would not be a bad thing.” Apologies for saying the opposite of what we meant. (This error was not replicated online.)

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India and China

Still treading on India's toes

Nov 16th 2006 | DELHI
From The Economist print edition

Trade is booming; but even that adds some new elements of mistrust

CLOSE friends have little need of formal professions of warmth. India and China are not there yet. Thus 2006 is officially “a year of friendship” between the two countries, culminating in a visit by Hu Jintao, China's president, to India on November 20th. China's ambassador in Delhi chilled matters this week, declaring Arunachal Pradesh, a state covering some 84,000 square kilometres (33,000 square miles) in the north-east of India, to be part of China. The dispute over the border is so long-running that India's reaction was no stronger than official outrage and unofficial weariness. Yet the calm reaction also shows how, on the Indian side, antagonism with China is already priced in.

Relations between the two countries have improved since 1998, when India angered China by justifying its tests of nuclear weapons with an oblique reference to the Chinese threat. The thaw is a tribute to a political process that has kept border talks going since 1988, and saw them elevated to a higher level in 2003. Progress has been slow, but that has been part of the point: the dispute has been in quarantine while relations improved in other ways.

The benefits can be seen in the growth of trade between the two countries. In urban India, the biggest Hindu festival of the year, Diwali, was this October lit up almost entirely by lanterns made in China, despite enthusiastic use of anti-dumping petitions by Indian firms to keep Chinese goods out. Two-way trade, worth only $1.5 billion in 1998-99, may reach $20 billion this year, with a surplus in India's favour.

Yet suspicions endure and will be hard to shift. Inside India's defence establishment, they are fuelled by three aspects of China's policy.

First, still, come the contentious borders. The outline of the eventual solution seems clear: the disputed land on the eastern end of the border stays with India and with China in the west. But that would represent acceptance by India of the outcome of its abject defeat in the two countries' war in 1962, and has always been politically difficult. China appears unwilling to help with even cosmetic concessions, and has been loth to define where it thinks the border runs. Indian officials think agreement is still some years away.

Second, Indians worry about China's traditionally cosy friendship with Pakistan, and its alleged help with Pakistan's nuclear-weapons programme. They point out that while Mr Hu will sign agreements on trifling cultural matters in India, in Pakistan, his next destination, he will sign nuclear-power deals worth billions

of dollars. They also resent China's assistance to Pakistan's navy, which will as a result by 2015 have as many frigates as India, according to Srikanth Kondapalli of Delhi's Jawaharlal Nehru University.

Third, China's military ties with India's other neighbours in South Asia make them jumpy. China has a defence co-operation agreement with Bangladesh, and has offered assistance to governments in Sri Lanka, Nepal and Myanmar. Other parts of India's hydra-headed government may feel more warmly towards China, but they will find it hard to silence the hawks.

For China, which tends to look on India not as a rival but as a poor neighbour afflicted by bureaucracy and democracy, suspicion springs less from fear than from pique at India's spurning of Chinese investment. One official Chinese newspaper complained recently that Indian approval for Chinese investments can take between six months and a year, and requires the endorsement of four bits of the bureaucracy, whereas investments from most other countries require approval only from the Reserve Bank of India, the central bank.

India has indeed blocked investments in ports and telecoms infrastructure. It considers both strategic assets which ought to be kept out of the hands of companies controlled by a foreign government that claims a large chunk of India. And it has thought out loud about drafting a law that would subject investments from proscribed countries to special scrutiny. A certain country with 1.3 billion people would probably be first on the list. This has prompted Chinese talk of retaliation.

So far, though, India has found other ways to keep Chinese companies out. Chinese businessmen operating in India grumble about the difficulty of getting visas for Chinese workers. “Chinese people are suffering very special treatment,” says Hongsen Wang, managing director of Sinosteel India, the largest Chinese importer of iron ore from India. Even Indian companies that have tried to import Chinese workers have had trouble.

India, in turn, points out that its information-technology companies, which have expanded into China, are winning business primarily from their multinational clients there, not Chinese firms or the government. All of which has conspired to keep the growth in cross-border investment lagging behind trade.

For that to improve, and for trade to keep growing, the two countries need to make their trade routes more direct and open up their markets to each other. There are still only six direct flights a week from Delhi to Beijing. More business and tourist travel might help dispel the lingering suspicions. But it will not happen quickly. “These are two old civilisations,” says C.V. Ranganathan, a former ambassador to China, “and their relationship will move at a civilisational pace.” That is too slow for many businessmen, and, to the extent it impedes trade and growth, too slow for the hundreds of millions in the two countries who have yet to reap much benefit from their growing economies.

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Vietnam and America

What war?

Nov 16th 2006 | BANGKOK
From The Economist print edition

Both sides strive to put the past behind them—and contain the rise of China

GEORGE BUSH visits Hanoi this weekend in the latest stage in a steady improvement in relations since America and Vietnam ended their war just over 30 years ago. Mr Bush's welcome will be sincerely warm, especially after the pact the two countries signed in May, in which America backed Vietnam's entry to the World Trade Organisation (WTO).

AP

Bill got there first

There was one awkward hitch before the president's visit: on November 13th the House of Representatives failed to pass a bill granting Vietnam "permanent normal trade relations", without which its access to its biggest export market rests on the whim of the American president. The Republicans failed to get the two-thirds majority they needed to rush the bill through in time for Mr Bush's visit. However, it should still pass (by a simple majority) in December, before the new, Democrat-controlled Congress takes over next year.

Mr Bush is the second American president to visit Vietnam since the fall of Saigon—and the second to have dodged fighting in the war. When Bill Clinton came in 2000, big crowds welcomed the man who in 1994 had scrapped America's trade embargo and a year later restored diplomatic relations. It had taken two decades to start undoing the bitter legacy of the war, and for Vietnam's communist government to emerge from its isolationist shell.

Now Vietnam is open for business. Its exports to America, worth $6.6 billion last year, should keep soaring, as should America's $1.2 billion of exports to Vietnam. Coca-Cola and Citibank had already arrived by the time Mr Clinton visited. Harley-Davidson motorbikes will soon be roaring on Hanoi's streets.

As co-operation on security and counter-terrorism has improved, American naval ships have, since 2003, been visiting Vietnam's ports. But there are still some awkward issues to clear up. Vietnamese victims of Agent Orange, a poisonous defoliant used by America in the war, are still seeking compensation. But the *Washington Post* this week quoted officials as saying the two countries had struck a deal in which America will pay towards removing residues of the chemical from Vietnamese soil. This month the two countries agreed to start the second phase of a joint programme to remove the huge amounts of wartime bombs and landmines that litter Vietnam, causing casualties even now. The two sides have also made progress on tracing the hundreds of Americans—and the much larger numbers of Vietnamese—listed as missing in action. On November 9th the Pentagon said the remains of an American airman shot down over North Vietnam had been identified.

America still describes Vietnam as “an authoritarian state” that abuses human rights. But in April it praised the country's advances in several areas, such as releasing some political dissidents and signing an agreement on religious freedom. As a result, on November 13th, it removed Vietnam from a blacklist of countries that suppress religion. The same day, Vietnam sent back to America a Vietnamese-American democracy activist it had detained for 14 months for “terrorist activities”.

The Vietnamese feel that but for the wars of the mid-20th century, their country would be as rich as Taiwan and Singapore. Their desire to catch up by doing business with America and other former foes has helped dispel any lingering rancour. Tony Salzman, an American entrepreneur who has several businesses in Vietnam, says he has never sensed the slightest hostility in the 14 years he has been there. Around half Vietnam's people were born after the war, he says, so for them it is something for the history books. America is naturally excited by a country of 83m people with low production costs, whose economy is growing almost as fast as China's. There is also an unstated mutual interest in containing China's rising influence in the region. In all, plenty of reasons to put the past behind them.

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Bangladesh

Closed for politics

Nov 16th 2006 | DHAKA
From The Economist print edition

And not open for business

Reuters

Get article background

FOR a while this week, Dhaka, one of the world's most densely populated cities, seemed no more crowded than a mid-sized Swiss town. On November 12th, two weeks after a caretaker government took over from a coalition led by the Bangladesh Nationalist Party (BNP), the main opposition, the Awami League, decided that it had failed “to prove its neutrality”. For four days it enforced a strike that brought the capital to a virtual standstill.

On the evening of November 15th, Sheikh Hasina Wajed, the League's leader, suspended the strike until November 20th. But the League threatened that the blockade would resume unless the interim government met its many demands. The most important is for the removal of the chief election commissioner, M.A. Aziz. The interim administration has to oversee elections in January. The opposition fears that the BNP, with the help of a partisan president, who also heads the interim administration, will rig the polls.

It has shown that it is capable of shutting the country down. Businesses, shops and petrol pumps were closed. International trade was disrupted, notably imports of materials for the garment industry. The currency, the taka, plummeted. Negotiators representing Prince Bandar of Saudi Arabia, who is keen to invest $330m—equivalent to about 10% of Bangladesh's foreign reserves—in a state-owned bank, left the country.

The economy, growing at about 6% a year, has so far defied political turmoil and the repeated use of the *hartal*—or strike. But its resilience may soon be tested by renewed disruption. The League's strategy is risky. The price rises caused by the strike antagonise the poor. Sheikh Hasina cited their plight when she called it off.

A resolution to the political impasse, however, seems nowhere in sight. The BNP and its allied Islamist parties say that Mr Aziz's is a constitutional post, so he has to resign of his own volition. Yet he bluntly refuses to quit, despite his apparent unpopularity. This week opposition supporters burned him in effigy. Shopkeepers announced that they would not sell goods to Mr Aziz or his family because his unwillingness to go was hurting business.

The opposition has tied its fate to the removal of Mr Aziz. For its supporters he has become the symbol of the interim government's partiality. It is doubtful whether a replacement could make much difference in practical terms. But his removal would be a moral victory for the League in a long election campaign that has turned ugly before it has even begun.

On November 12th the president, Iajuddin Ahmed, decided to deploy the army in an attempt to maintain law and order, without even informing his advisers. The order was rescinded the same evening, but even BNP appointees on the panel now criticise the president's style.

Three days earlier Mr Ahmed told the country's top civil servants that the administration had become a “presidential form of government”. Mr Ahmed later retracted the comment. But it has left many asking whether a president who so casually talks about changing Bangladesh's constitutional arrangements is the right man to oversee parliamentary elections.

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Hepatitis B in China

B is for bigotry

Nov 16th 2006 | BEIJING
From The Economist print edition

One-tenth of China's population risks discrimination

IN CHINA, as elsewhere, people with HIV/AIDS often suffer discrimination. But a far bigger group of virus carriers in China encounters similar bigotry. For 130m Chinese carrying the hepatitis B virus, which can cause fatal liver diseases, it can be hard to get a job—or even a decent education, as a group of schoolchildren in the far west recently found out.

Carriers of hepatitis B often show no symptoms. In China, many first learn they are infected when they apply for work or a place at university and undergo medical examinations. In September elite state-run boarding schools in Urumqi, about 2,400km (1,500 miles) west of Beijing, gave new entrants a blood test and barred entry to 19 children found with the virus. Hepatitis B, like HIV, cannot be transmitted through food or casual contact. But victims of discrimination are often reluctant to draw attention to their plight. However, these parents were in anguish at the loss of a golden educational opportunity. A small local NGO, the Snow Lotus HIV/AIDS Education Institute, took up the children's cause and published details on the internet. State-run newspapers picked up the story.

The authorities in Urumqi, however, have dug in their heels. Chang Kun, who founded the NGO, fled to Beijing after police raided his office and seized his computer and health-education materials in October. He saw this as retaliation for his campaigns on behalf of the children as well as 156 hepatitis B-carrying university students in Urumqi, expelled from their colleges last year.

Seven of the children's families tried to sue the local education bureau, but came under pressure. Activists say some of the parents were told by police to drop the case. A lawyer representing the parents, Zhang Yuanxin, says the parents agreed to do so this week. State-controlled newspapers had already gone quiet about the issue.

Lu Jun, who runs a website in the central city of Zhengzhou to provide information for fellow hepatitis B carriers, says that there has been less international pressure on China to act than on HIV/AIDS. This year China issued a statute banning discrimination against people with HIV/AIDS, but it has yet to do the same for hepatitis B, which kills many more people in China than does AIDS.

In 2003 a hepatitis B-carrying student stabbed and killed an official because he was denied a civil-service job. He was executed. Since then, the central government has begun to act. Early last year it declared that carriers would no longer be barred from government posts. This month it banned advertisements featuring treatments for certain conditions, including infection with hepatitis B. Such advertisements often convey misinformation about how the virus is spread. Their message, not the government's, seems to rule in places like Urumqi.

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Central Asia

No tulips please

Nov 16th 2006 | ALMATY
From The Economist print edition

They're bad for our job prospects

THE authoritarian leaders of Central Asia were this week coming to terms with a remarkable turn of events. For the first time one of their number had consented to reduce his authority, rather than extend it. The culprit was Kurmanbek Bakiev, president of impoverished Kyrgyzstan. After a week of largely peaceful protests by thousands of people in the capital, Bishkek, he ceded some of his powers to parliament. In return, he was assured that he could serve out his term until 2010. In neighbouring countries, leaders watched askance, wary of the fancy ideas this precedent might give their own citizens.

Kyrgyzstan's parliamentarians took all of two minutes to pass a new constitution on November 8th and cement their gains. This was surely a “dubious world record”, mocked state television in oil-rich Kazakhstan. Its reporter then calculated that the protests had cost Bishkek $130,000 in lost revenues each day, not counting the losses suffered by traders and investment that had been deterred. “Pseudo-democratic freedoms can give a country pride, but leave it hungry,” he huffed.

The Organisation for Security and Co-operation in Europe and the American government praised Kyrgyzstan for its move to greater democracy. Central Asian leaders differed. Besides their self-interested argument that a strongman at the helm provides continuity and predictability, they fear that unrest in Kyrgyzstan could stir up religious extremists, believed to be far more active in the south of the country than Kyrgyzstani officials admit.

Their efforts to convince their own populations that democracy cannot be imported and is simply bad for business are less than subtle. The state-run press does not portray Kyrgyzstan's tulip revolution of March 2005, which brought Mr Bakiev to power, as a triumph of people-power protests against corruption and family rule. Rather, it harps on the two days of looting in Bishkek at the time.

Little or nothing has been reported about the reasons for this month's demonstrations in Bishkek. Much larger than last year's, they were provoked by Mr Bakiev's reneging on his promises to strengthen parliament by making constitutional changes. His appetite for reforms had diminished noticeably after he was voted into office in July last year and had placed five of his brothers in high-level positions.

Kazakhstan's President Nursultan Nazarbaev appears to have been sufficiently nervous about another possible revolution that he made an unscheduled visit for a chat with his Uzbek colleague, Islam

Karimov, in Tashkent on November 3rd, the day after the demonstrations began.

Unlike Kazakhs, Uzbeks were left unaware of the events in Kyrgyzstan. Mr Karimov demonstrated last year how he deals with protesters. Two months after the tulip revolution, between 700 and 1,000 demonstrators were shot and killed in the city of Andijan by government troops.

In Tajikistan, events in Bishkek had little resonance. Its people are still too traumatised by a bloody five-year civil war in the 1990s to seek political change. Many Tajiks view Kyrgyzstan as utterly unsafe. The president, Imomali Rakhmonov, is seen as the guarantor of the country's security. Last week he was re-elected in a poll so far from free and fair that, in Kyrgyzstan, it would have led to another revolution.

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Afghanistan's auxiliary police

There's marijuana in their socks

Nov 16th 2006 | PUNJWAI
From The Economist print edition

And their feet point the wrong way

Infographics

KNOWN as “thieves in uniform”, the standing of the Afghan police in the eyes of most residents of the southern province of Kandahar is just below that of the despised stray dogs. Their habit of turning roadside checkpoints into extortion rackets is just one blatant example of their criminality and corruption. The police force is one reason why, five years this week since the austere and brutal regime of the Taliban was overthrown, so many people in Kandahar cannot decide whom they hate more: the new government or the Taliban revivalists fighting it.

In the battered police station at Punjwai, where heavy fighting against the Taliban has dragged on for five months, police morale could not be lower. Over a frugal lunch of bread and dripping, the local commander, Bismillah Jan, says the Taliban would kill them if they went home, so they stay at the station day and night. Their pay, $70 a month, barely supports them, they are few in number, and equipment and training are dismal, with only 20 guns for 110 policemen in the district.

The police's disarray has left a law-and-order vacuum across southern Afghanistan, which the Taliban and local warlords have been quick to fill. Now the government of Hamid Karzai is attempting a risky solution. The first “auxiliary policemen” are training. Unlike regulars, recruited and trained centrally, these will be local men. The aim is rapidly to increase police numbers from, typically, about 50 in each district to several hundred. They will be paid the same as regular policemen.

Punjwai, which will get 300 of the new police, shows how badly they are needed. In September a big NATO offensive, Operation Medusa, supposedly cleared out the Taliban. But since there were so few police, and NATO's soldiers were tied up protecting two road projects, the Taliban soon reoccupied much of the ground.

There are big dangers in building up the “auxiliary” force. It might become the tool of a tribal faction or local warlord. The idea is to recruit what is in essence a local security force, but with a broad enough base to ensure that the government is not merely supplying, training and arming existing militias. Careful screening of the recruits is supposed to maintain the tribal balance and keep out unsavoury elements. In Kandahar, only 109 out of 200 initial volunteers were accepted.

Even so, the new recruits failed to impress Nasrullah Zarifi, who commands the main police-training centre in Kandahar. “These people have destroyed my training centre,” fumes the general. “They are just

criminal people. Do we want quality or just to extend the numbers?”

General Zarifi says he threw six men off the course for propagating Taliban ideology, and expelled several more after finding marijuana in their socks. Some recruits rioted after deciding that their beds aligned their feet with Mecca while they slept. With pay and conditions so poor, it is not surprising that the force fails to attract top-notch candidates, and training only lasts ten days, compared with eight weeks for regular police. More worrying are reports that recruits in several districts came disproportionately from one tribe.

Conscious that local warlords might try to co-opt the new recruits, Kandahar's provincial police chief is planning to create joint stations covering two or three districts. The auxiliaries will work under the main police command not local police commanders, and form what he calls “a mobile reserve”. It is an intriguing idea, but hardly what was originally envisaged.

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America, Israel and the Palestinians

Hamas carries on with the dance

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From The Economist print edition

AP

Could the common anti-Hamas front be about to crumble?

WHEN you are a lame duck, the company of other limpers can be comforting. George Bush, chastened by his party's defeat in the mid-term elections, warmly welcomed Ehud Olmert, Israel's prime minister, his conscience still smouldering from the recent accidental killing of civilians by Israeli shellfire in Gaza. Mr Bush reaffirmed his tough stance on Iran. Mr Olmert delighted Mr Bush (and infuriated Democrats) by praising the war in Iraq. But on both men's minds must hang the question of what recent events will mean for their future co-operation.

America continued to fight on Israel's side, vetoing a UN Security Council resolution that would have condemned it harshly for the carnage in Gaza. But in return, the Arab League voted on November 13th to break the international embargo on aid to the Hamas-run Palestinian Authority (PA). How they will get money to the PA is another matter; banks have been enforcing the blockade for fear of American lawsuits and sanctions. But it is bad news for the American-Israeli strategy of isolating Hamas in the hope of changing its behaviour (or, say some, of causing its collapse).

Moreover, Hamas has moved a step closer to agreeing a unity government with the ousted Fatah party. The two had been fruitlessly pursuing the idea for months as a way to break both the deadlock between them, which has fuelled factional violence among Palestinians, and the international embargo.

Now talks are afoot on how many portfolios each party will have, reminiscent of the Lebanese model of factional power-sharing. Each party also gets to nominate a certain number of unaffiliated “technocrats” for the main jobs. Muhammad Shubair, an academic who is the putative prime minister, and Ziad Abu Amr, a smooth-talking politician often mooted as foreign minister, are both close to Hamas, though not members of it; Mr Abu Amr has often acted as an intermediary between the two parties. A possible finance minister is Salam Fayyad, who won respect from foreign donors when he had the job in the previous Fatah government, but left to form his own party.

All are men whom the Americans are thought to find acceptable. Still, American officials insist, any unity government, no matter who participates in it, will remain a pariah unless it meets the three conditions of the international “Quartet” (America, the EU, the UN and Russia): recognise Israel, renounce violence and accept previous Israeli-PA agreements. And, even as the talks on a coalition progress, Hamas hardliners have been vowing with renewed vigour never to recognise Israel, while the party's more equivocal moderates have been silent.

Some Fatah people interpret that as a Hamas attempt to scuttle the unity government. But it might also be a way to weaken further the anti-Hamas alliance, by driving a wedge between the Americans and their Quartet partners. At a meeting last month Lieutenant-General Keith Dayton, America's security envoy to the Palestinians, said the Quartet should give up hoping for a unity government and back Mahmoud Abbas, the Palestinian president, by whatever means necessary to help him take on Hamas. The other three members, says a diplomatic source, balked at this idea as “tantamount to backing one side in a future civil war”.

On November 15th they met again in Cairo, but made little progress. The risk, for America and Israel, is that if Fatah and Hamas manage to unite—still a very big if—several countries will want to offer them something in return, in the hope that this will encourage them to move towards the Quartet's conditions. Then the boycott really would crumble, allowing Hamas to prolong its defiant stance.

A longer-term risk is that, even if forced out of office, Hamas may return easily. Though most of the main Palestinian pollsters have done no surveys since September, most found then that while support for a unity government of some kind was high, support for Hamas had dropped little or not at all. That suggests that Palestinians want the party to step down for now to ease the pressure, but don't resent it. In particular, Ismail Haniyeh, the current Hamas prime minister, remains popular. Some Palestinian commentators are already talking about him as a candidate for president when Mr Abbas's term ends in a little over two years.

Israelis are worried that in America the new Democratic Congress, armed with an about-to-be-published bipartisan report on Iraq, will recommend a softer approach to Iran, and perhaps Syria and the Palestinians too, as a way to boost America's standing in the region and help it solve the Iraq mess. But for now, there are no other ideas for how to deal with Hamas.

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Algeria and France

It's so hard to say sorry

Nov 16th 2006 | ALGIERS
From The Economist print edition

Testing the limits of friendship

AFP

Sarkozy sombre at the monument

WHEN Jacques Chirac, France's president, paid a triumphant trip to Algiers in 2003, riding high on his opposition to the invasion of Iraq, cheering crowds showered him with confetti. This week his interior minister and leading presidential contender on the French centre-right, Nicolas Sarkozy, got a much surlier welcome.

Newspapers dragged up comments, made during protests in the French *banlieues* last year, when Mr Sarkozy referred to the rioters, many of them of Algerian origin, as “scum”. He was bombarded with questions over the formal apology that Algeria has requested from France for its 132 years of colonial rule. With his eye on mending his reputation with France's large immigrant population, Mr Sarkozy laid a wreath at the monument to the victims of Algeria's independence war. He looked suitably sombre and called the colonial system unjust. But he stopped short of apologising for France's actions: “I told Abdelaziz Belkhadem [Algeria's prime minister] that you can't ask sons to say sorry for their fathers' mistakes,” he said.

The demand for an apology stems from a law, passed by the French parliament in February 2005, referring to the “positive role of the French presence overseas, especially in North Africa”. The offending clause was later removed, but it caused huge resentment in Algeria, where France's annexation of the country ended in 1962 only after a brutal eight-year war.

Though the French retain deep political, cultural and commercial ties with Algeria, their dominance has long been waning. A string of other countries are keen to strengthen links with a nation that has rich hydrocarbon deposits. The United States, recognising Algeria as an ally in its war on terrorism, is expanding security co-operation and providing training for Algerian forces. Russia agreed earlier this year to write off almost $5 billion of Soviet-era debt in return for a pledge to buy arms worth $7.5 billion. Chinese firms are taking on big construction projects and businessmen from the Gulf are sizing up investment opportunities.

But Mr Sarkozy did bring one particularly welcome gift. Three years ago, Mr Chirac promised to remedy a big Algerian grievance: the tortuous, weeks-long wait for visas that Algerians suffer for wanting to travel to Europe (about 80% of such applicants want to go to France). Mr Sarkozy was able to announce that his government had come good on its promise by negotiating with its European partners an end to the lengthy cross-checks that had been introduced in 1995, when Algeria was in the throes of its war with Islamist rebels.

The French say that scrapping the cross-checks will immediately knock 15 days off the waiting time for Algerian visa applicants (250,000 for France last year, of which about 60% were accepted). It also shows that the French are confident that, with Algeria's insurgency largely extinguished, police co-operation between the two states has a fair chance of preventing terrorists from slipping through.

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Lebanon

Pulled every which way

Nov 16th 2006 | BEIRUT
From The Economist print edition

Shias and Sunnis, plus their respective patrons, tug at a tired country

ALL it takes to see that Lebanon is a starkly polarised place is to drive into Beirut from its airport. Portraits of Rafik Hariri, the five-time Sunni Muslim prime minister slain by a truck bomb in February last year, adorn advertising hoardings along the highway, captioned “We Shall Never Forget”. A rival, guerrilla advertising campaign is also under way. “America is the root of all disasters,” says a sign hanging from an overpass.

Actually, there is no need to go to Lebanon at all to understand that this small country has become a zone of contest between pro-Western forces, ranked behind the political heirs to Mr Hariri, and the Syrian-Iranian “resistance” axis that backs Hizbullah. Last week American officials gave warning of an impending Iranian-inspired putsch against Lebanon's elected government, which is controlled by a coalition of Hariri-aligned politicians known as the March 14th group. This week Ayatollah Ali Khamenei, Iran's supreme leader, gave warning of an Israeli-American plot to steal the fruits of what he called “the great victory” won by Hizbullah in last summer's war with Israel.

Both charges are true, in a way. Hizbullah emerged bruised but politically strong from what it portrays as an American-orchestrated war. As a result, its demands for a bigger share of power have grown more strident. For a start it is threatening to foment street demonstrations unless March 14th grants the party and its allies a veto over cabinet decisions. The ruling coalition, made up of Sunni Muslim, Druze and some Christian parties, offered to give Hizbullah supporters more cabinet seats. But they balked at ceding the power to push through key projects, rejecting what the prime minister, Fouad Siniora, calls the tyranny of a minority.

Specifically, the government accuses Hizbullah of trying to block approval of an international tribunal to try suspects fingered by a UN investigation into a series of assassination attempts against March 14th figureheads, including Mr Hariri. The reason for this, say Hizbullah's critics, is that any trial is likely to implicate the party's main conduit for weaponry, Syria, or at any rate some of Syria's former proxies inside Lebanon, which was under the sway of Syrian forces until the killing of Mr Hariri provoked mass demonstrations that prompted their ignominious withdrawal.

Even as it denied these charges, Hizbullah and its allies pulled six ministers out of the cabinet, a move that handicaps Mr Siniora's government by stripping it of Shia representation, and so opening it to charges of failing the constitutional duty to represent all 18 of Lebanon's recognised sects. Mr Siniora could, in theory, appoint non-Hizbullah Shias to fill the seats, but the party's hold over the sect, which makes up 30% of Lebanon's population, is so strong that they would lack credibility.

Nevertheless, Mr Siniora's rump cabinet called the bluff by swiftly approving the UN's terms for setting up the tribunal. Amid debate over the legality of this approval, Hassan Nasrallah, the Hizbullah chief, promised his supporters that the government, which he accused of having backed Israel during the war, would soon fall. Mr Siniora faced further pressure from the country's titular president, Emile Lahoud, whose tenure is a legacy of Syrian influence. He is understandably keen to denounce the tribunal as many of his associates have been implicated in the assassinations. In a letter to the UN, Mr Lahoud described cabinet approval of the tribunal as legally null and void.

Hizbullah still says its supporters may take to the streets, while March 14th leaders warn they would stage counter-demonstrations. Worse yet, many Lebanese fear that some small incident could spark clashes between Shias and pro-government Sunnis, who make up another 30% of the population.

At the same time, the country is struggling to recover from the war. Despite a saturation of foreign aid,

thousands remain homeless. Far more have suffered loss of their livelihoods, with farmlands clogged by Israeli cluster bomblets and businesses bankrupted by the collapse of tourism. A recent survey found that nearly half of all Lebanese hope to emigrate.

Yet it may be that, almost as a perverse result of all these pressures, Mr Siniora's government will survive. The Lebanese have experienced disaster before, and few wish to go through it again. The endurance, so far, of the ceasefire with Israel, despite Shia dislike of the presence of thousands of UN peacekeepers, and despite Israeli violations of Lebanese airspace, is one sign of a slackened will for confrontation.

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Kenya

No end to the problem

Nov 16th 2006 | NAIROBI
From The Economist print edition

Ever more reasons to worry about endemic corruption

THERE are few people left, even in Kenya, who dispute the fact that the country is one of the most corrupt in the world. Guesses about how much senior officials pinch from the public coffers range from $1 billion a year and up. But if that aspect of the country's corruption problem is well known, it is now doing other kinds of damage. For a rotten Kenya has also become an international security concern.

That was the message of Kim Howells, a Foreign Office minister from Britain, the former colonial master, on a visit to the country last week. In unusually frank terms, Mr Howells argued that because everyone, from Mombasa dockers to senior government officials, can be bought off, Kenya is “wide open” for drug cartels and terrorists. The cartels move large quantities of cocaine and heroin through Kenya and the drug money washing through Kenya's political bloodstream is making it even harder for honest ministers and civil servants to do their job.

Terrorism is another concern. Intelligence sources suggest that a few jihadists among the Somali Islamists in Mogadishu may be readying suicide attacks against targets in Kenya. Corruption certainly makes it easier for them to move between the two countries. Small bribes at remote border posts and larger bribes at Kenya's domestic airports are enough to make Somalis invisible to Kenya's security services. Corruption at the highest levels provides cover for stealing down the line. Some of the proceeds go on country club memberships and luxury cars. But far more is spent on political campaigns: rallies, paying off tribal elders, gangs to intimidate opposition supporters, and sometimes the voters themselves.

The present government was elected on an anti-corruption platform, but has done little to fulfil its promises. From the start, it borrowed money from many of the same individuals as the previous regime, and set about paying off debts with similar dodgy schemes. A few of these were laid bare by John Githongo, a government-appointed investigator who had to flee the country when his findings got too close to the top. His revelations did prompt two ministers to resign, but this week they were both reinstated. Some of the $300m or so involved in the scams has been returned to the treasury.

Donor countries are confining their aid to ever more strictly audited projects. Sir Edward Clay, an outspoken former British high commissioner to Kenya, says donors should be using their own laws more effectively against corrupt African officials. “Corruption is too far down the development agenda,” says Sir Edward. Kenya has made some progress. Mr Githongo and other brave whistle-blowers, after all, are Kenyans speaking for Kenya. But too many of them have had to flee abroad. Nor is there a single conviction in sight.

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Congo

It's Kabila

Nov 16th 2006 | KINSHASA
From The Economist print edition

First an election result, now the threat of violence

Reuters

Winning in style

AFTER weeks of fake results and over-hasty proclamations of victory in the country's presidential run-off election, Congo will soon have its first democratically elected leader in over 40 years. As *The Economist* went to press, the last batch of figures had been posted on the electoral commission's website, giving President Joseph Kabila 58% of the vote against his rival Jean-Pierre Bemba's 42%. The Supreme Court still has to confirm the result, but Mr Kabila's victory is all but certain.

What is less certain is how Mr Bemba's camp will respond. Politicians around the former rebel have bombarded the authorities with allegations of fraud. On November 14th his party called the electoral process a “hold-up” and rejected the initial results, threatening to renege on promises to accept any outcome peacefully. For his part, the putative victor appealed for calm, but he also underscored his command of the police and the army and gave warning that he would not allow the situation to get out of hand.

Fears of that happening are very real. Over the weekend, Mr Bemba's gunmen fought running battles in the heart of the capital against policemen and soldiers acting under Mr Kabila's command. Although peace was restored after several hours of heavy fighting, the clashes reminded the city's residents of the three days of fighting that followed the first round of voting in August. At least 30 people were killed then.

After a decade of conflict most ordinary Congolese have modest expectations, hoping at most that the elections will provide them with a chance to rebuild their lives in a wretched but mineral-rich nation. But the election has highlighted Congo's deep ethnic divisions. Mr Kabila won most of his votes in his native, Swahili-speaking east. Mr Bemba won over much of the Lingala-speaking west and the capital itself. There is a tangible fear that the country might lapse back into the sort of war that cost the lives of over 4m people between 1998 and 2003. UN peacekeepers are on high alert.

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The euro

An uncommon current

Nov 16th 2006 | BUDAPEST AND PRAGUE
From The Economist print edition

East European countries are struggling to join the euro. What if they give up?

ON THE surface, the ex-communist countries' economic outlook looks bright. Growth is rapid, foreign investment strong, and their economies are becoming more sophisticated, swapping labour-intensive exports for services and higher value-added products. The European Bank for Reconstruction and Development, in its annual update published this week, said that growth this year in the 29 countries it covers would be 6.2%, compared with 5.7% in 2005.

But sunny weather is a bad test of rainwear. The real question is why the new democracies are not dealing with their fundamental problems now, while outsiders are so willing to lend and invest. Inflation is too high, public finances bloated and reform slow. And the next big goal of the new and future members of the European Union—adopting the euro—is receding into the distant future.

In a forthcoming study, Susan Schadler of the International Monetary Fund and a co-author estimate (see chart) that borrowing costs in central and eastern Europe are up to a percentage point less than you would expect, given the political, economic and financial risks these countries pose. The likely explanation, she argues, is a "halo effect" from the EU. Markets see membership as a big plus, especially with euro adoption in view. In theory, all EU countries (barring Britain and Denmark, which have an opt-out) are supposed to join the common currency. Yet in practice, those that want to join have found it unreasonably difficult. And others are not sure that they want it at all.

So far only Slovenia (see article) has managed to meet the criteria for membership, which set the ratios of government deficits and debts to GDP, exchange-rate fluctuations and inflation rates. Slovenia will adopt the euro on January 1st. Lithuania (which missed thanks to inflation just 0.1% above the limit) and Estonia (arguably the soundest and most dynamic economy in the whole region) are unlikely now to be able to join before 2010.

Yet both have a foot in the euro zone already, because their

currencies are pegged to the euro and backed by currency boards. The price of having only one foot in is some residual exchange-rate risk (dismantling a currency board is much easier than leaving the euro) which may add ten basis points to bond yields; the cost (around 0.2% of GDP annually) of currency conversion; and the lack of a voice in the euro area's management.

Some of the ex-communist states' economic problems stem, excusably, from success. High rates of investment in poorish countries are unlikely to be met by domestic savings alone; the resulting inflows swell the current-account deficit. Estonia's economy is growing at 12% annually. Inflation was 4.3% in mid-2006. With a budget already in surplus, it was hard to see how the authorities could have cut inflation to the required 2.6%.

But other difficulties are more troubling. Joaquin Almunia, the EU's economic and monetary affairs commissioner, lambasted the Hungarian authorities this week for a budget deficit that will reach a whopping 10.1% of GDP this year. Progress towards meeting the membership conditions appeared “disheartening”, he said.

Though Hungarians now think they may adopt the single currency only in 2013, they are still keen to do so in principle, not least because so many firms and households have borrowed cheaply in foreign currency in the expectation that membership is inevitable.

In Poland, by contrast, reluctance to join the euro is growing. Many in the ruling conservative coalition see it as an unacceptable infringement of national sovereignty. Urszula Grzelonska, the favourite to become central-bank governor next year, said this week that she had “increasing doubts”. The government has already said it wants a referendum in 2010.

In theory, Poland does not have the right to question the principle of joining the euro: the EU's new members are supposed to join once they pass the membership tests. But it can hold a vote on the timing. Swedes voted against the common currency in a referendum in 2003, though the government portrays it as a postponement, not rejection. Brussels has huffed and puffed, but can do little.

Poland would in any case struggle to meet the 3% limit on budget deficits now set for joining the euro. The European Commission is already worried by Poland's public finances. When new rules on how to count pension costs bite in April, the budget deficit will jump, it predicts, by two percentage points to 4% in 2007. The next year it will be only a shade lower. The EU is also dissatisfied with the haplessly run finance ministry, which has seen six ministers since last year's elections.

The third big central European economy is the Czech Republic. Despite dire, deadlocked politics, it has the best macro-economic position, to the point that its interest rates are 75 basis points lower than those of the euro zone. Zdenek Tuma, the central-bank governor who, wags say, runs the country in the absence of a proper government, talks warmly of the benefits of an independent monetary policy, whereby his bank sets interest rates. That will be lost if his country joins the euro area. The single currency will also require stronger public finances and a more flexible labour market, he says; adopting the euro depends on political will both for reform and integration with the rest of Europe. “If there is a club, we want to be in it,” says a top Czech.

The case for small economies joining the euro is overwhelming, But for the (relatively) bigger ex-communist countries it is more complex. National currencies bring flexibility, but also vulnerability. Westerners are beginning to feel uncertain too. The euro zone may already have too many misfits (Italy, for example, or Greece). Even if prickly Poland and sleazy Hungary could eventually massage their statistics to meet the criteria, would bringing them into the inner sanctum really be advisable?

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Slovenia

Pocket president

Nov 16th 2006 | LJUBLJANA
From The Economist print edition

Slovenia eyes a rare moment of glory

RUNNING the European Union for six months is a big job, even for a large country. For a small one, it means a rare limelight—and a huge headache. In barely a year's time, and with fewer civil servants than in a big country's foreign ministry alone, Slovenia will be running the 4,000-odd meetings and eight ministerial get-togethers of the EU presidency. With a population of 2m it will be the smallest country (not counting Luxembourg, which in effect delegates its turn to France and Germany) to lead the EU, and the first ex-communist state to do so.

Alamy

Never mind the agenda—admire the scenery

The aim, says Janez Jansa, the prime minister, “is to run it smoothly”. An official is blunter: “Just not screw it up”. Luckily, Slovenian officialdom is unusually efficient for an ex-communist country and already planning hard. The incumbent, Finland (population 5.3m), is helping. So are Germany and Portugal, which hold office in 2007.

But Slovenia hands over to France, which has notoriously poor ties to the ex-communist world. Janez Lenarcic, the minister for the EU presidency, points out hopefully that Slovenia is the only European country with a statue honouring Napoleon's soldiers. They briefly liberated the country from Habsburg rule, and let schools teach in Slovenian.

That language has not so far featured much in European diplomacy; there is a scramble to find enough interpreters and translators. The real difficulty, though, is not organisation but politics. Slovenia hopes to push EU expansion to other bits of ex-Yugoslavia such as Macedonia and neighbouring Croatia. But it is unclear where it will stand in the other big debate, between market-minded liberalisers, mainly in northern and eastern Europe, and the more dirigiste economies of the centre and south. The evidence so far is that Slovenes talk like Estonians, but act like Austrians. Mr Jansa has notably failed to push through a promised flat tax, privatisation and other reforms—the people, he says, just don't want that kind of thing. Others think his government is hobbled by its cronies.

By the standards of post-communist politics, Mr Jansa, a sardonic former dissident, is something of a class act; it is easy to imagine him chairing an EU summit. But besides him and Mr Lenarcic, talent is thin. The foreign minister, Dimitrij Rupel, is oddly abrasive for someone with two decades' diplomatic experience. Asked how other ministers will guide 26 EU colleagues through intricate topics like farm-subsidy reform, diplomats in Ljubljana sigh and roll their eyes.

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Italy

Signor Thatcher?

Nov 16th 2006 | ROME
From The Economist print edition

Reform may be finally becoming popular in Italy

CYNICISM about Italian politics is easy, but sometimes misplaced. On November 11th Francesco Rutelli, one of two deputy prime ministers in Romano Prodi's centre-left government, published a blueprint for liberalisation. Some bits seemed almost trivial, such as deregulation of school buses, hotel shuttles and limousine services. Others ranged wider: a little more competition in energy and railways, making suppliers of public services submit tenders; and measuring their performance by consumer satisfaction.

Mr Rutelli is known more as an adroit manoeuvrer than as a conviction politician. Originally an anti-clerical Radical, he became a Green before drifting to the centre and taking the leadership of Democracy and Freedom, a mix of progressive Christian Democrats and liberals that is one of the three big parties in the sprawling ruling coalition. In that government, he is visibly under-employed, with a portfolio that includes only culture and tourism.

AFP

Prodi and Rutelli wrestle with reform

Those close to the prime minister note testily there is little in the Rutelli plan not suggested earlier by Mr Prodi himself. A reform round in July drafted by another minister, Pierluigi Bersani, liberalised pharmacies, taxis and legal fees. Mr Prodi has promised more: already, two other ministers are working on plans to shake up local government and the professions.

Yet, for all that, Mr Rutelli's initiative matters. In a society in which public opinion has long favoured regulation and cartelisation, a politician with a nose for votes is advocating liberal reform. Reaction to Mr Bersani's earlier move was positive too. That could be a historic shift.

But the liberalisers need a powerful sponsor. So far, it is the leftists in Mr Prodi's government who have had the upper hand: the draft 2007 budget, for example, is long on tax increases, short on spending cuts. But Mr Rutelli is signalling that, once the budget has been passed, he expects Mr Prodi's backing.

Who would manage the reforms? Mr Prodi feels that co-ordinating ministries is his job. But his position requires him to hold the balance in his coalition between moderates, the ex-Communists and still-Communists. Mr Bersani's bill won broad support in cabinet only because it affected non-unionised groups such as pharmacists, lawyers and cab drivers. If the government is serious about reform, it will sooner or later run up against Italy's powerful trade unions. Though Mr Rutelli's plan offers safety nets to those hurt by liberalisation, someone will need to stiffen the government's resolve.

Mr Rutelli wants that job. He proved a flamboyant and effective mayor of Rome. Now the big time beckons.

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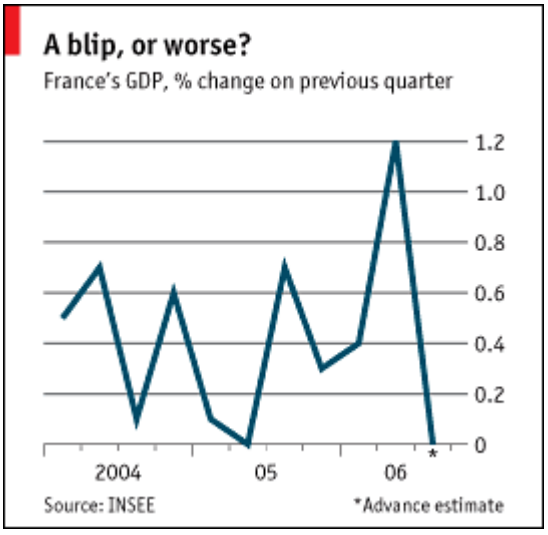
France's economy

Empty promises

Nov 16th 2006 | PARIS
From The Economist print edition

France's economy stalls while politicians' promises multiply



EVEN with a healthy economy, the Socialist Party's spending promises would look steep. They will cost, it reckons, an annual €49 billion ($63 billion) by 2012. That is a hefty 32% increase on the current government's plans. But whoever wins the Socialist nomination for the presidential election in five months' time—Ségolène Royal, the front-runner, Dominique Strauss-Kahn and Laurent Fabius, were standing in a first-round ballot this week—will face a faltering economy.

In the three months to September, quarter-on-quarter GDP growth was zero, against 0.5% forecast by the Bank of France. Full-year growth is now likely to be barely over 2%—at the bottom end of the government's forecast range of 2-2.5%.

Some suspect that this simply marks a correction from an exceptional second quarter, when GDP grew by 1.2%, largely thanks to a big build-up of companies' stocks. A growing number of firms now expect to raise output, according to the monthly business-confidence survey compiled by INSEE, the state statistics body.

Thierry Breton, the finance minister, has repeatedly insisted this year that the economy is on a “dynamic trend”, poised for take-off. He expects a rebound in the final quarter. There is no sign yet that consumer spending, the chief motor of the economy, is easing off. And unemployment is still falling. It could drop from 8.8% to 8.3% by the end of 2007, according to Gilles Moëc of Bank of America.

But the view is gaining ground that France could start to lose its position as the euro zone's most robust big economy. Eric Chaney, Morgan Stanley's chief economist for Europe, says the latest data reflect a structural problem, not a correction.

Over the past ten years, France has been remarkably resilient, with average annual GDP growth since 2001 of double that of Germany or Italy. But this year and next the French economy could well lag behind the average for the euro area. “As soon as growth in the French economy exceeds the trend rate, it is not sustained,” says Marc Touati, chief economist at Natexis Banques Populaires. “Our structural growth rate is only 1.9%.”

One reason, argues Mr Chaney, is that French industry has lost competitiveness within the euro zone, and is ceding market share to freshly competitive German and even Italian firms. When choosing suppliers, French consumers and companies are increasingly looking abroad, he says, for lower prices and for better service. Mr Chaney blames that partly on a high minimum wage, up by 38% since 1997, and to the impact of the 35-hour working week on companies' ability to staff back offices and customer-service centres.

That has hurt French exporters too. France has run a current-account deficit since 2004, which can be only somewhat explained by strong demand for imported consumer goods. Airbus, along with other companies, has partly blamed a strong euro for its loss of business to America's Boeing. Visiting the troubled firm's subcontractors in Toulouse this week, Dominique de Villepin, the centre-right prime minister, provoked a brief fall in the euro by saying: “We cannot allow the European Central Bank to act alone on rates.”

The surging Paris stockmarket, however, suggests that the corporate sector is in good health. Its main index, the CAC 40, reached a high for the year this week. One reason is that top companies make four-fifths of their profits abroad. Another is that big multinational firms are thriving, but their smaller counterparts are not.

To make matters worse, household debt threatens crucial consumer spending. The once-high gross household savings rate is now below 15%, from a peak of nearly 18% in late 2002. Modest income-tax cuts, planned from January, may not be enough to prop up consumption.

The Socialists hope that economic growth will finance two-thirds of their programme (new taxes make up the rest). But even their conservative calculations assume growth of 2.5%. The French economy has not managed that for six years.

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The Caucasus

The art of levitation

Nov 16th 2006 | YEREVAN
From The Economist print edition

How Armenia copes with its isolation in the combustible Caucasus

NOWHERE is living next to big countries trickier than in the Caucasus. Georgia, Armenia and Azerbaijan were for centuries swallowed by rival empires; when the last of them, the Soviet Union, collapsed, three territorial wars broke out, all of which may yet re-erupt. Now Georgia is in a cold war with Russia.

Next-door Armenia's geographical plight might seem the worst in the Caucasus—or anywhere. It is landlocked and poor; of its four borders, those with Turkey and Azerbaijan are closed following its bloody but successful struggle for Nagorno-Karabakh, a province of Soviet Azerbaijan mostly populated by Armenians. Its other neighbours are Georgia (under an economic blockade by Russia) and Iran. Yet despite the war, the economic collapse that went with it and a terrible earthquake that preceded it, Armenia seems to have levitated out of trouble.

It benefits from an indulgence not afforded to pro-Western Georgia. Per person, Armenia is one of the biggest recipients of American aid (thanks to the powerful diaspora there, which remembers vividly the massacres of 1915). Yet that American help does not trouble Russia, which has a military base in Armenia. GDP is growing—though still pitifully low: monthly wages are around $150. Towns and villages in the beautiful, barren countryside are still poor and dilapidated, but Yerevan is full of construction cranes and posh cafés.

But levitation has its limits. After some progress in the late 1990s, reforms have stalled. The famed cognac aside, exports are puny. Armenia relies on foreign aid and remittances from the huge diaspora; emigration (see article) has put the population well below the official 2.9m figure. The international balance is also precarious. Some in Russia want the Armenians to take sides against the Georgians, perhaps by stirring up the Armenian minority there. “We refuse to choose,” says Vartan Oskanian, the foreign minister. Indeed: alienating Georgia would be suicidal.

But the Kremlin's leverage is growing. Russian firms already control the energy sector and want a greater stake elsewhere. Mr Oskanian says “our needs today are too dire” to worry about future risks. Azerbaijan's hydrocarbons windfall makes it sound confident, even bellicose, stoking Armenian reliance on Russia.

American interest in the pipelines that link the Caspian to the Mediterranean, doglegging round Armenia,

mean that renewed fighting would echo far beyond the Caucasus. Internationally sponsored talks about Karabakh limp on—Mr Oskanian met his Azerbaijani counterpart this week—and Western diplomats try to sound upbeat. But a deal, or even a fudge that would at least allow normal trade relations, looks all but impossible. Sporadic shooting continues.

One reason is that bad governments in both countries bang the nationalist drum for want of wider legitimacy. Armenia's Robert Kocharian has emulated his sponsors in the Kremlin, squeezing the media and rigging elections. Corruption flourishes. It is hard to find an Armenian politician who does not want to succeed Mr Kocharian when his presidential term expires in 2008; it is harder still to find one who thinks the vote will be fair. Like Ilham Aliev, who inherited power in Azerbaijan from his father, Mr Kocharian promises just enough change to pacify America. Unsurprisingly, considering their history, most Armenians are too cynical to expect much better from their rulers.

Like acrobats in a human pyramid, the Caucasus countries are inevitably affected by their neighbours' behaviour. Russia's closure of its border with Georgia, for example, hurts Armenian traders. Such outsiders' jostling would be much easier to bear if the three (relative) tiddlers had a common line. But they are all, as Raffi Hovannisian, a former Armenian foreign minister, says of his country, “long on civilisation, short on statecraft.”

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Armenians in Turkey

Not dead yet

Nov 16th 2006
From The Economist print edition

Turkey's Armenian population is growing

IN THE grimy alleys of Istanbul's Kumkapi district the air is thick with a rarely heard language: Armenian. Marina Martossian, who has been working illegally for five months as a cleaner, is typical of 40,000 compatriots there. She is delighted with her $300 monthly pay and calls her Turkish bosses “the kindest people in the world”.

That's a big change. Bitter debate over the fate of the Ottoman Armenians—did the mass killings of 1915 constitute genocide?—has fuelled decades of enmity. A survey by TESEV, a think-tank in Istanbul, showed some 70% of Armenians had a negative view of the Turks: a tenth called them “enemies”; a similar chunk “barbarians”. Among Turks, 34% thought poorly of Armenians (17%, bizarrely, believed the Armenians were Jews).

Turkey's Armenian minority dwindled to 80,000. In 1993 Turkey sealed the border with Armenia, after it seized the province of Nagorno-Karabakh from the Turks' Azeri cousins. The issue poisons other ties too: this week Turkey broke off military relations with France, after parliament there voted to criminalise denial of the genocide.

Now Turkish officials go easy on the Armenians—in contrast to other illegal workers. They also welcome changing attitudes among diaspora Armenians, especially among those who actually visit Turkey. In an e-mail widely circulated among émigrés this month, Kardash Onnig, an Armenian-American artist, who recently returned from an arts festival in the eastern province of Kars, says he “never imagined that an Armenian artist singing Armenian songs could elicit a response of such brotherly humanity. I was in a sea of Turks dancing to Armenian tunes. What joy! My eyes were full of tears.”

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Charlemagne

Soot, smoke and mirrors

Nov 16th 2006
From The Economist print edition

Europe's flagship environmental programme is foundering

ASK a European what the continent is good at, and sooner or later he or she will say protecting the environment. Our economies may be struggling. We may be failing to integrate Muslims. But, by golly, we are green and cuddly, like a Martian teddy bear.

Yet at a time when policies on climate change are coming under scrutiny, the European Union's flagship programme, the emission-trading scheme, is in serious trouble. It was set up last year amid high hopes: it is the first international arrangement that uses markets to reduce soot and smoke. But unless reformed, it will go down as a good idea, badly executed.

The system works as follows. National governments decide how much carbon the five dirtiest heavy industries in their countries may spew forth (the industries are things like power generation, pulp and paper, and metal bashing). They then allocate “permits to pollute” to each company in that line of business. If a firm wants to go over its limit, it must buy “pollution permits” from cleaner firms or credits from developing countries that have set up special projects to lower emissions.

The case for such a European policy is strong. When it comes to the environment, individual countries suffer “the tragedy of the commons”: they capture the benefits of polluting while the costs are dumped on the common land, air and water. Ideally, pollution controls would be universal, but since (as the Kyoto treaty showed) that is impossible, the EU is the next best thing: big enough to make an impact, coherent enough to constrain members' behaviour. Arguably, if climate-change measures cannot work in the EU, they cannot work at all.

Moreover, as EU policies go, this one is fairly well designed, in principle anyway. It manages to set a carbon price and encourages trading in environmental assets (the pollution permits). That should be the most efficient way to control emissions. It is a welcome contrast to the command-and-control systems, such as the common agricultural policy, that the EU has preferred in the past. And although economists may argue forever about the relative merits of carbon trading versus a carbon tax, Europe's decision to go for the former at least has the merit of decisiveness. Britain's environment minister calls the scheme “the most innovative and efficient method yet invented for reducing carbon emissions”. Arnold Schwarzenegger, the governor of California, wants to set up a similar arrangement between his and other states. Indeed, Gordon Brown, the British chancellor of the exchequer, says the European and Californian schemes one day should be linked as part of a worldwide carbon-trading network.

Yet even while lauded as a model for others, the scheme is failing at home. It will lead to cuts in

emissions only if the permits are strict enough, so the question of who allocates them is vital. For political reasons, the EU left the power of allocation to national governments. As a result, what should have been an exercise in setting rules for a new market became a matter of horsetrading about pollution limits, with powerful companies lobbying for the largest possible allowances.

Last year, governments gave away (ie, did not sell) pollution permits that amounted to more than the pollution companies were actually spewing forth. That risks making the scheme pointless. The European Commission is now reviewing proposals for allocations in 2008-12. If approved, these would allow companies to increase emissions by a further 15%.

Lax allocations do more than just fail to cut greenhouse gases (bad enough, you might think, given that this is the main point of the scheme). They also damage the market. When it became clear, in April, that most allocations were larger than actual emissions, the price of carbon halved almost overnight. Some volatility is probably inevitable in a new market, but when combined with irresponsible behaviour by governments it hardly encourages people to enter the emissions-trading business.

It gets worse. The plunging price sends a market signal to developing countries that have installed pollution controls partly so that they could sell the resulting “pollution credits” for a nice profit. That no longer looks like a good idea.

A blackening reputation

Similarly, some countries (Germany, France and Poland) have scattered permits around like confetti while a few (Britain, Ireland and Spain) have been sparing because they want to cut emissions. Companies in the second group are buying permits issued in the first, so the market is transferring resources from places that are using the scheme to curb pollution to those that are not. Brilliant.

The European Commission could reject the proposed national allocations outright and insist that offending governments slash the allowances substantially. They could also push governments to sell the permits, rather than give them away (taxpayers would like that too). But in the long run, argues Michael Grubb of Cambridge University, countries need independent agencies to issue the permits, just as there are independent central banks to issue money.

And if governments refuse? They might remember that they have already promised to meet emission-reduction targets under the Kyoto protocol. If they miss them they will sooner or later face a choice: either buy up offsetting pollution credits from countries that have cut their emissions (thus sending the carbon price soaring again and spending lots of taxpayers' money). Or flout the Kyoto obligations they solemnly undertook and admit to voters that they were not really serious about curbing greenhouse gases.

In a recent British report on climate change, Sir Nicholas Stern said the European emission-trading scheme could become “the nucleus of future global carbon markets”. It could. But only if politicians allow it to work properly.

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Terrorism

Dark days, difficult times

Nov 16th 2006
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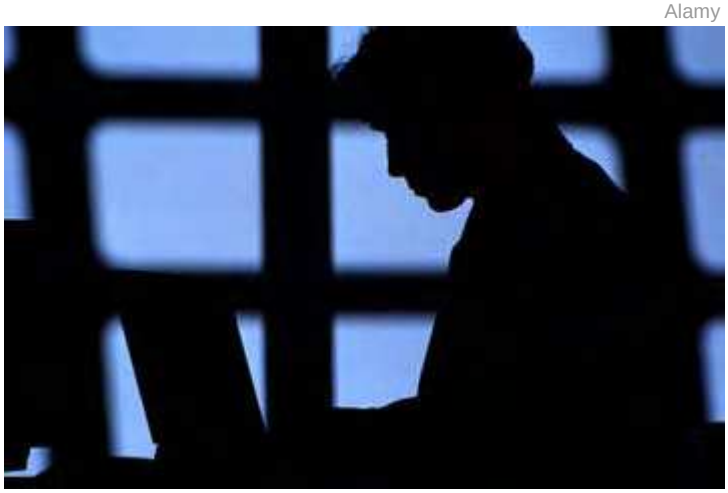
Alamy



Countering al-Qaeda's new British foot soldiers

WHAT is to be done about the growing number of British Muslims who are said to be plotting against their country? Crack down on the 1.6m-strong Muslim population as a whole and the chances of increased hostility grow. Go easy and Britain may become a haven for those intent on fomenting hatred and carrying out terrorist attacks.

This dilemma was thrown into sharp relief by Eliza Manningham-Buller, the head of Britain's domestic-intelligence service (MI5), in a speech last week. The number of plotters has reached 1,600, doubling in 16 months, and MI5 knew of 30 conspiracies, she said. Future attacks could be chemical, biological or even involve some kind of nuclear device.

Since her remarks not a day has gone by without alarming pronouncements from politicians and pundits on “the terrorist threat”. Many suspected that ministers were preparing the public for draconian new anti-terrorist laws in the Queen's Speech, a catalogue of forthcoming legislation. But the queen duly spoke on November 15th and no specific measures were announced (see article).

One reason for this may be political: the government has been embarrassed in attempting to tighten such rules in the past and will want to know it can win before trying again. A more fundamental reason is that the ways in which terrorists operate these days are less susceptible to control by warrant-wielding policemen.

As the ways of the terrorists change, so do those of the security services. These days, the spooks who try to keep an eye on these people are focusing on two areas in particular: the internet and Pakistan.

The new recruiting-grounds

Islamists discovered long ago that the internet was the perfect tool for them. Terrorists exploit the medium to screen executions, preach the jihadist cause and raise money. Websites can be taken down by the authorities, but they soon reappear. “Blogs are today's revolutionary pamphlets, websites are the new dailies and list-servers are today's broadsides,” says Audrey Cronin of Oxford University.

But Islamist terrorist groups no longer use the internet just as a broadcasting medium. Since mosques and universities have been infiltrated by the spooks, those places are no longer the terrorists' main recruiting-grounds. Some still play a role but more people are now being indoctrinated by friends and families at home, and through internet chat rooms and websites. Radical “cyber-mosques” also exist. In a film shown by BBC's “Newsnight” on November 14th, Omar Bakri Mohammed, a Muslim cleric banned from Britain for inciting violence, was said to be preaching *jihad* online.

Thomas Hegghammer of the Norwegian Defence Research Establishment, a think-tank, notes another trend: terrorist groups are actively targeting European audiences. Speeches by al-Qaeda representatives posted on the web are now being given English subtitles—significant for British Muslims, who are less likely to speak Arabic than their continental brothers.

The web is not just for indoctrination and recruitment. Military tactics and bombmaking techniques are also available online. But the internet is no substitute for military training. For Britain's would-be terrorists, much of that takes place in Pakistan.

Half of Britain's Muslims—about 800,000 people—are of Pakistani origin. Many travel to Pakistan often to visit family and friends or to do business. Almost all do so entirely innocently.

Most of the would-be bombers of July 21st in fact had African ties—and only some of those charged with conspiring to blow up transatlantic flights in August had family connections in Pakistan. But three of the four suicide-bombers who attacked London on July 7th 2005 had roots in Pakistan and two had travelled there not long before. Before his arrest Dhiren Barot, sentenced last week to at least 40 years in jail for planning to kill thousands of people in attacks in Britain and America, was about to visit Pakistan to get money for the planned atrocities. He is also believed to have received military training there.

Many of the 30 plots of which MI5 is aware have links to al-Qaeda in Pakistan, according to MI5. The Pakistani government seems unable to control the apparent growth in strength in areas bordering Afghanistan of both al-Qaeda and the Taliban. This worries many. Intelligence sources think that Britain's close connection with Pakistan has increased its vulnerability to terrorist attack.

The Home Office has commissioned a review of the laws and powers for fighting terrorism, and may consider new legislation afterwards. A delay is sensible, for the target is a moving one. Heavier-handed rules could strengthen the existing perception among many Muslims that they are being victimised—and, among other consequences, reduce the chance of their providing information.

The solution, if there is one, is a long, slow, many-stranded business. The goal is not only to immobilise terrorists but also to wean away the sympathisers who shelter them. Ms Manningham-Buller noted that around 100,000 Britons thought the July 7th bombings were justified.

The government is trying to do some of this by talking to Muslim groups but that is of limited use when almost all Muslims disapprove of the war in Iraq. According to intelligence sources, the number of suspects has shown a “steady increase” since the invasion in 2003.

But the vulnerabilities of a free society are also its strengths. Allowing Islamists to broadcast on the internet, no matter how objectionable, allows spooks to monitor their activities and can provide information about new threats. Britons of Pakistani origin can export democratic values as well as import terrorism, says James Arbuthnot, chairman of the select defence committee. Ministers hate to be seen to do little. But vigilance and amity may yield more than handcuffs all round.

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The Queen's Speech

Playing tough

Nov 16th 2006
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“Security” is at the heart of Tony Blair's last Queen's Speech

AFTER a decade in office, governments, never mind prime ministers, can run out of steam. But there was little sign of that in Tony Blair's tenth and last Queen's Speech, setting out the legislative programme for the year ahead. This was a substantial package, consisting of 29 bills with others promised, including controversial new anti-terrorism laws.

Mr Blair himself will not be around to see it all through. But although his probable successor, Gordon Brown (who was all but anointed by Mr Blair), will have priorities of his own, he has no disagreement with the emphasis on security in the Queen's Speech.

Security has become an infinitely elastic concept covering everything from crime to pensions and climate change. But the red political meat of this programme was in the series of Home Office bills dealing with immigration, organised crime, anti-social behaviour and “re-balancing” the criminal justice system in favour of the victim.

Mr Blair, Mr Brown and John Reid, the home secretary and only conceivable heavyweight challenger to the chancellor, all believe that the Tories have made themselves vulnerable on law and order issues—normally their strong point. They are convinced that Conservative opposition to tough anti-terror laws and the introduction of ID cards, on the grounds that they infringe civil liberties, has put them “on the wrong argument” with most voters.

And they scoff at David Cameron's impeccably liberal insistence that some young thugs need love more than punishment. It just goes to show that the Tory leader is a sheltered toff who is hopelessly remote from the reality of life as most people experience it, they think.

Mr Brown is especially keen to contrast his toughness with Mr Cameron's equivocations. At the weekend he accused Mr Cameron of not understanding “the scale of the threat we face” as he indicated his own support for extending to 90 days the 28-day limit on detaining suspects without charges. Security issues, it seems, will also be at the heart of next year's spending review, the platform for Mr Brown's premiership.

There are, however, risks in this strategy. Voters instinctively believe that Tories are nastier (and therefore better) on these issues than Labour. Mr Cameron may sound and look a bit soppy, but voters will probably give his party the benefit of the doubt.

Another problem is that by drawing attention to the failings of the criminal-justice system, the government also underlines its own failure to sort it out over the past ten years. According to the British Crime Survey, 80% of people think the system respects the rights of the accused and only 36% think it meets the needs of victims. But whose fault is that?

Finally, a great deal depends on faith in the Home Office's ability to deliver. The department that Mr Reid described last spring as “not fit for purpose” is not bad at churning out legislation, but it's pretty useless at implementing it. Security may be the new name of the game, but it's a dangerous one for this or any other government to play.

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Religion

Onward Christian soldiers

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Churchmen begin to speak up

ARE British Christians, weary of turning the other cheek to the twin challenges of secularism and rival faiths, learning to fight back? A string of public statements from senior church figures which have lacked the usual careful emollience suggests they may be.

Two of these blasts have come from Christian bishops whose origins make them immune to the charge of white paternalism. John Sentamu, the Ugandan-born Archbishop of York, made an impassioned attack on the removal of Christian symbols from public places in the name of political correctness. The rot started, he said, when the city fathers of Birmingham decided in 1998 to rename the Christmas holiday "winterval". Since then, said the second-ranking prelate of the English church, there had been "many other instances where Christianity is being systematically eroded from public view".

An even sharper note was sounded by Michael Nazir-Ali, bishop of Rochester, whose forebears included Pakistani Muslims. Some Muslims had a "dual psychology", he said, that insisted on playing the victim in some places while asserting a dominant role in others. This culture of complaint—which demanded help for oppressed Muslims, but insisted that harsh Muslim regimes were untouchable—was impossible to satisfy and people would be wrong to try, the bishop suggested.

Some of the institutions which Archbishop Sentamu singled out for attack were at pains to defend themselves. For example, the prelate deplored the fact that greeting cards from government offices said "Season's Greetings" rather than "Happy Christmas". This prompted Tony Blair's office to retort that the prime minister, at least, still referred to Christ's nativity in his cards, unless the recipient was known to profess another faith. Then there was the Post Office, with its new range of stamps showing "Christmassy themes", such as Santa Claus, but not the new-born Messiah. It said its end-of-year stamps were decided by "rotation"—implying that Jesus Christ might yet make a comeback.

If Christianity's newly-raised voice does not always sound consistent or assured, that is partly because the faith occupies a peculiar place in Britain, both inside and outside the world of power. The Anglican church rests on deep and ancient privileges—not just as the state religion which the monarch must profess, but also as the guardian of the nation's most important monuments and the biggest force, after the state itself, in education.

But such is the cool detachment of Britain's established religious culture that passionate religious statements of any kind leave people confused and embarrassed. British Catholics, fighting for their own place in the sun, are also constrained by the taboo on strong expressions of faith.

Yet in a Britain where secularism and Islam have powerful, self-confident constituencies, Christianity may have to learn to deliver a more coherent message to society. That hope appears to underlie the recent creation of a new religious think-tank, Theos. The fact that it was blessed by both Catholic and Anglican hierarchs suggests that old inter-Christian rivalries are being set aside for the sake of a broader mission.

In a similar vein, Rowan Williams, the Archbishop of Canterbury, said this week that Anglicans and Catholics were now "two churches standing in the middle of a secular and unfriendly environment" with similar tasks. But he puzzled some of his own flock by hinting that Anglicanism might in time reconsider its 12-year-old practice of ordaining women.

Theos's starting point, says its director, Paul Woolley, is that secularism is on the decline: Britons are likely to become more religious, in part because of migrants from pious places such as Poland, the Philippines and much of Africa. Hence there is a need to encourage good, intelligent religious discourse

over the opposite kind.

Perhaps—but British Christians still have some thinking to do about which corner they want to fight: is it that of an old institution defending its privileges, or that of a vigorous minority challenging the mainstream? Jonathan Bartley, of the liberal Christian think-tank Ekklesia, has argued that the Anglican church's “prophetic” role—as a deliverer of painful but necessary messages about the wrongs of society—is incorrigibly compromised by its privileged position as the state religion.

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Shooting

A palpable hit

Nov 16th 2006 | PERTHSHIRE, SCOTLAND
From The Economist print edition

Bloodsports are rescuing the countryside

THE stag lies in a clump of purple heather, only his splendid antlers visible. “Wait for him to stand, then shoot,” whispers the gamekeeper. Half an hour later, the beast leaps to his feet; stiff from the wait, the stalker centres the crosshairs of her rifle on the beast's chest and slips the safety catch—only for a jeep to roll directly across the line of fire. The gamekeeper curses as the stag races off.

That deer, on an estate in Perthshire, was fortunate, for every year tens of thousands of stags are despatched by amateur stalkers. Half a million Britons shoot animals for sport, according to a recent report carried out by PACEC, an economic consultancy. Shooting driven lowland game—ie, blasting at birds as they are “beaten” towards the guns—and killing urban pests such as rabbits and foxes are even more popular. The ban on foxhunting with hounds has also given shooting a boost: hunters now exterminate cornered foxes by bullet. Indeed, the Countryside Alliance, which lobbies on rural matters, says foxhunting is more popular than it was before the ban.

It is lucky that people like shooting things because rural Britain needs hunters as never before. Farmers' fortunes have plummeted since the mid-1990s. Last year total income from farming fell by 8.9% to £2.5 billion ($4.6 billion). In real terms, earnings have fallen by almost 60% since 1996. Two-thirds of England's farmers have had to look for other ways to wring a living from their land, and half now run sport and leisure activities. Shooting is an easy option: many farmers already shoot privately and increasing numbers are now running public shoots or leasing land to shooting syndicates.

The countryside itself also stands to gain. Farmers who focus on shooting are likely to protect woodland, plant a wider variety of crops to attract birds, spray less and leave stubble in fields for longer to draw wildlife, point out groups such as the British Association for Shooting and Conservation. A change in the European Union's farm subsidies offers further encouragement. Payments are no longer linked to producing crops or animals but to caring for the land, so farmers can improve their lucrative shoots and be paid by Brussels for doing so.

Another benefit of shooting is that it brings in new money from outside the rural community, says Martin Turner, an economist at the University of Exeter. Businesses such as shops and hotels profit from the influx of armed townies, whose purchases of lardy-cakes and hand-knitted jumpers boost the local economy.

“Shooting used to be perceived as a rich man's hobby, but it isn't,” says Stuart Fuller-Shapcott, who farms 1,000 acres in Scotland's Roxburghshire. Five years ago he began organising pheasant shoots, which now account for a quarter of his time. “All sorts are taking it up. My regulars include a ferry captain, an engineer, a blacksmith and a banker.”

Stalking deer, meanwhile, is growing more popular south of the border. Thanks to climate change and increased forestation, the number of English deer has doubled in the past 25 years, to perhaps 750,000—about twice as many as in Scotland. To protect crops and woodland, and to reduce the risk of car accidents caused by road-hopping deer, the government wants more stalkers. Officials are considering shortening the “closed season” during which females mothering their young cannot be shot. They also plan to make the sport more accessible by scrapping the old laws that govern game shooting, including the requirement for a licence.

This support for Britain's surviving bloodsports may rile animal-rights activists, who, after getting foxhunting outlawed, have shooting firmly in their sights. The old practice of rearing pheasants in captivity for a career as quarry is a particular target. Canny farmers are developing wild-bird shoots in

case shooting reared birds should one day be banned.

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Farepak

“A Christmas Carol” for modern times

Nov 16th 2006
From The Economist print edition

A lean festive season for Britain's deserving poor

THIS Christmas, according to Deloitte, a business-advisory firm, the average Briton will spend £378 ($715) on presents, 22% more than in 2005. But not those unlucky enough to have saved with Farepak, a “Christmas hamper club” set up in the 1960s. It has gone bust, leaving its 120,000 customers without the £40m they put aside during the year. Farepak's administrators have warned that customers can expect to get back at most a few pence in the pound. The festive goods they ordered in January and paid for in dribs and drabs—hampers of food and drink, gifts from the company's catalogue and vouchers for high-street stores—will never arrive.

The Dickensian prospect of poor families facing a Christmas of bare cupboards and empty stockings has led the government to set up a relief fund. Supermarkets, high-street stores, MPs and others have so far contributed £4.5m. Ian McCartney, the minister for consumer affairs, has called the situation a “national emergency”.

Hamper clubs are used by nearly a million people who want to be thrifty but often find it tough. Agents, usually friends or family members, encourage them to put scarce money by. Placing their savings somewhere less accessible than a bank account seems more important than getting a couple of pounds of interest. And they surely didn't realise that if the worst happened they would be treated as unsecured creditors, rather than being protected as a bank's customers are.

Farepak's agents deposited its customers' money into an account with NatWest, a bank. From there it went directly to an account held by European Home Retail (EHR), Farepak's parent, with HBOS, another big bank. According to HBOS, EHR's practice was “collecting customer receipts from all the subsidiary companies and using them as working capital to fund the ongoing business of the group”.

EHR had been in deficit for several years. Like other Christmas clubs, it was feeling the squeeze as customers switched from high-margin hampers to retail vouchers, which cost clubs a few percentage points less than their face value. That was compounded in EHR's case by poor business decisions: in 2000 the firm bought DMG, a book and toy retailer, for £35m; four years later it sold it for just £4m.

What finally tipped the group into administration, though, was a cashflow crunch. Until last Christmas Farepak settled with the company that supplied its vouchers only after these had been spent. The shops where the vouchers were used invoiced the voucher company in January, and final payment was due from the hamper clubs in April. But earlier this year one of Farepak's rivals went bust. Retailers lost tens of millions and the voucher company went bankrupt. Smarting from their losses, retailers insisted that Farepak, like other clubs, pay for vouchers before they were used—in this case, just eight months after Farepak had settled its 2005 accounts. It went into administration on October 13th—around the same time its customers were making their final payments—and dragged EHR down with it.

Sir Clive Thompson, EHR's chairman, says HBOS is to blame. HBOS ripostes that it provided banking services to EHR, not Farepak, and says pointedly that none of the management's rescue plans was viable “given the absence of any additional funding from the owners of EHR”. MPs whose constituents have been affected have called on HBOS to make up the shortfall, and on EHR'S directors to dip into their own pockets. Officials at the Department of Trade and Industry are looking into the collapse; an MP has called for the Serious Fraud Office to do so too.

One likely outcome is that the Financial Services Authority will be asked to regulate hamper clubs. Although too late for Farepak's customers, tighter rules would mean that future savers who can't trust themselves not to fritter away their Christmas money could be sure that hamper clubs would not do so

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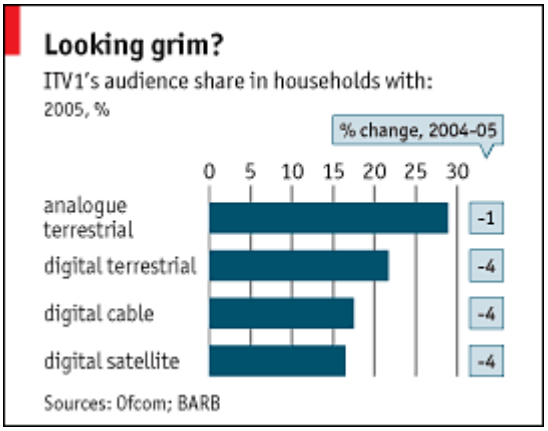
Television

Here's looking at you

Nov 16th 2006
From The Economist print edition

In spite of all its difficulties, ITV has plenty of suitors



LIKE all the best plot twists, it was unexpected. The announcement on November 9th by NTL—a heavily indebted cable-TV firm—that it was interested in a merger with ITV, Britain's biggest commercial broadcaster, caught the City completely off guard. But perhaps investors should have known better. After all, it was only in March that ITV rebuffed an offer from Apax Partners, a private-equity firm; and once news of the NTL bid became known, rumours of interest from other quarters began to surface.

In fairness to the pin-stripe brigade, it is hard to see, at first glance, why anyone might want to buy ITV. The firm seems to many to be in terminal decline. It has had a torrid time since it was formed in 2004 from the merger of Carlton and Granada, two big regional television companies. The rise of multi-channel TV has hurt ITV's market share, as viewers in multi-channel homes desert ITV's generalist offerings for more specialised channels (see chart). Poor-quality programming and competition from the internet have not helped, and advertising revenue is down by 8% so far this year. Charles Allen, ITV's chief executive, resigned in August and has not yet been replaced (one candidate is Michael Jackson, a former boss of Channel 4, favoured by WPP—a big advertiser—and thought to be in talks with NTL).

NTL is mum as to why it wants to buy ITV but analysts have their own ideas. NTL too has suffered at the hands of BSkyB, as Mr Murdoch's satellite firm has bought up the rights to lucrative content such as Premiership football matches and recent films. Its high-tech cables allow the sort of interactive viewing that media soothsayers see as the future of television but it owns precious little content to send down them. The wholesale prices Sky charges for its premium programming have eaten into the cable industry's profits for years.

ITV's advertising revenues, at £1.6 billion ($3 billion), are still big enough allow it to engage in the expensive business of developing new programmes, says Ian Watt of Enders Analysis, an independent media consultancy, although its recent efforts have not been inspiring. Others highlight potential tax advantages, or point out that Sir Richard Branson, a flamboyant billionaire with a track record in the media, is one of NTL's biggest shareholders. They speculate that Sir Richard may simply be engaging in a spot of empire-building.

None of these arguments seem entirely satisfactory, however. “Buying the company is rather like walking past a department store, admiring the Belgian chocolates, and then buying the entire shop to get at them,” admits Mr Watt. Others question whether NTL is in a fit state to take over anyone just now. It has already bought Telewest (a rival cable operator) and Virgin Mobile (a mobile-phone firm) this year, and is struggling to absorb both. The company—worth £4.4 billion—is lumbered with £6 billion in debt, and ITV is likely to cost at least another £5 billion. Ofcom, the media regulator, has hinted that there may be competition worries too.

But NTL is not the only potential bidder. News of the offer has sparked rumours of interest from other quarters, including Time Warner, an American media giant, RTL, a German firm that owns Britain's commercial Channel Five, and several private-equity groups.

Nick Bell, an analyst at Bear Stearns, explains the interest by arguing that ITV's prospects are not as

bleak as is commonly supposed. “As the market fragments, the value of being a mass-market broadcaster rises,” he says. Firms in Europe and America have been able to exploit this by raising advertising rates even as viewing figures fall, but that option is not open to ITV. Worries over the merged firm's dominance in the commercial-television market led Ofcom to forbid it from raising its rates when the merger was first approved. Many believe that, as the firm's market share continues to decline, the regulator will relent.

Britain's switchover to digital television, due in 2012, may help as well, says Mr Bell. ITV is required at present to provide a large chunk of worthy but unprofitable public services such as religious shows and children's TV. The end of analogue television will mean the end of the spectrum scarcity that justifies such restrictions, and Ofcom has indicated that it will loosen them considerably. The regulator reckons that providing these services costs ITV over £200m a year—cash that could doubtless be more profitably spent, particularly if new management can improve the firm's lacklustre programming. Any bid would be a big gamble, but it might just pay off.

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Interest rates

Not so fast

Nov 16th 2006
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Another rate rise looks less likely but it cannot be ruled out

WHEN the Bank of England raised the base rate by a quarter-point to 5.0% on November 9th, it came as no surprise. The City was much keener to work out what the bank's monetary-policy committee would do next. In particular it wanted to know whether there would be another rate rise next year, as was generally expected by the markets.

On November 15th the bank offered some clues in its quarterly *Inflation Report*. This was more doveish than many had foreseen, painting a more benign outlook for inflation than in August (see chart). Consumer prices are currently increasing by 2.4% a year, above the government's target of 2.0%. The bank thinks inflation will rise further over the next few months. But its central projection, based on the market view that rates will rise next year by another quarter-point, shows inflation returning close to the target in the second half of 2007—much earlier than in the August forecast. By mid-2008 inflation drops to just below 2.0%.

Another of the bank's forecasts suggests that this month's rate increase may have done the job. This projection shows that if the base rate stays at 5.0%, inflation will be virtually at the 2.0% target in two years' time—the time it takes for a monetary tightening to exert its maximum effect in curbing price pressures.

This week's economic figures also suggest that the markets may have run ahead of themselves in predicting another rate increase. Inflation had been expected to rise to 2.6% in October but instead it stayed unchanged at 2.4% because of falling petrol prices and a smaller-than-expected contribution from higher university tuition fees. A slowdown in the growth of average earnings also helped the inflation outlook.

A further monetary tightening may now look less likely, but the bank has left the door open to push up rates again if necessary. It is forecasting quite strong growth in demand over the next couple of years, even though the report says there is “relatively little spare capacity in the economy as a whole”. However, Mervyn King, the bank's governor, said on November 15th that there was particular uncertainty about the economy's supply side, not least over the scale of migration, which is poorly captured in official statistics.

In these circumstances, the rate-setters are putting more weight on what is happening to costs and prices. In particular, they will be watching alertly the crucial pay round in early 2007, when a lot of settlements are due to be agreed. The worry is that the jump in inflation to 3.7% according to the broader retail-prices index, which is often used as a benchmark in pay deals, will help wage negotiators bump up pay. The bank will also be keeping a beady eye on companies. Here its concern is that firms will try to push through price increases in order to restore profit margins, which have been squeezed in recent years by higher energy costs and extra pension-fund contributions.

The bank may have sounded doveish this week. But adverse developments in costs and prices over the next few months could easily turn it hawkish again.

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Bagehot

A sad, bad business

Nov 16th 2006
From The Economist print edition

The police cash-for-honours investigation has become a continuing nightmare for Tony Blair

Get article background

FEW maxims about politics have acquired as much resonance as Enoch Powell's observation that “all political careers end in failure”. Though he has been Labour's most potent election-winner and will, unusually, leave Downing Street at a time more or less of his own choosing, Tony Blair is facing the real possibility of something much worse than failure: shame and humiliation.

This has nothing to do with Iraq or the billions wasted on a partially reformed health service. The toxic miasma hanging over the prime minister's last months in office emanates from the remorseless and protracted police investigation into what has become known as the cash-for-peerages scandal.

Over a year ago documents were leaked from the recently created House of Lords appointments commission suggesting that several wealthy businessmen nominated for peerages had been rejected for failing to disclose loans made to the Labour Party. It later emerged that Downing Street had advised them to do so. But when the police announced last March that they were investigating a possible breach of the law, it still seemed implausible that they would do more than go through the motions.

After all, it was more than 80 years since Arthur Maundy Gregory had been prosecuted under the Honours (Prevention of Abuses) Act—a piece of legislation passed after Lloyd George's uniquely flagrant sale of honours. Yet for much of the modern era, professionally run election campaigns have required large sums of money to pay for expensive advertising, and there has been a steady stream of newly ennobled peers who just happen to have given money to political parties. This is perilously unfamiliar territory for PC Plod to trample over in his size 12s.

Yet trample he has. The senior officer leading the investigation, Assistant Commissioner John Yates (or “Yates of the Yard”, as the press has dubbed him), promised to go wherever the evidence led and he has been as good as his word.

So far three people have been arrested for questioning, including Lord Levy, Mr Blair's chief fund-raiser,

who was briefly detained in July. Past donors, party officials, Downing Street aides, the entire 2005 cabinet and Michael Howard, the Tory leader at the last election, have all been contacted and some have been interviewed under caution. It has not been a pleasant experience for those involved.

Lord Sainsbury, Labour's most generous donor over the past decade, was visibly shaken after being interviewed last summer. He resigned as science minister last week for “personal reasons”. Lord Levy, who has made it clear that he does not intend to take the rap for others, is said by one Downing Street insider to be in “quite a bad way”.

Cheered on by the newspapers, it is almost certain that the police will soon want to interrogate Mr Blair. It is not yet known whether he will be cautioned—in other words, treated as a suspect rather than just as a witness. But given his previous insistence that he takes full responsibility for the way in which money was raised for the party, it seems probable. Chequers, the prime minister's country house, has already been chosen as the venue for the encounter in order to forestall television coverage of Mr Yates and his men banging on the door of Number 10.

It would be difficult to imagine a worse political nightmare for Mr Blair. For once, he has no ability to influence events. The operational independence of the police means that they are their own masters in this affair—the investigation will go wherever Mr Yates decrees and will last until he and his superiors think the job is done.

The attorney-general, Lord Goldsmith, who sits in cabinet, was forced last week to say that he would appoint an independent QC to advise him on whether charges should be brought and against whom. To make matters worse for Mr Blair, the investigating team, no doubt enjoying its place in the limelight, has assiduously leaked details of its progress. Potential interviewees often learn when they are to be questioned from the newspapers. And there is nothing that Mr Blair can say in response.

In his predicament, some sympathy is due Mr Blair. Thanks to stringent rules governing ministerial behaviour and a terrifying press, British public life is pretty unsleazy by international standards. It was to clean things up further that the Lords appointments commission was set up—by Mr Blair himself.

His increasing reliance on rich individuals to finance the Labour Party was the consequence of his laudable efforts to lessen dependence on the unions and thus their influence on policy. Worried that Labour would be outspent by the Tories at the last election, he was under pressure to bring in the money. And after the public mauling of prominent donors in the past, Labour fundraisers convinced themselves that anonymity would open purse strings—crucially, loans, unlike donations, did not have to be declared publicly, if made on commercial terms.

A chance for Gordon

“Smoking-gun” evidence that honours were sold will be hard to uncover. If Mr Blair does find himself in the dock it is much more likely to be because the “loans” at issue were not made on commercial terms and thus should have been declared. It sounds almost technical. But if proven, that shabby attempt to exploit a legal loophole would damage his reputation irreparably.

Until now the main effect of the police investigation has been to feed the public's debilitating cynicism about politics. It is, however, an opportunity for Gordon Brown to push ahead with reform. By placing a low ceiling on election spending, introducing a largely elected House of Lords and tying a very modest increase in state funding for parties to their ability to recruit new members, the old cash-for-honours problem could finally be put to rest. At least some good would then have come from what is otherwise a sad, bad business.

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United Nations

An ambassador's fight for life

Nov 16th 2006
From The Economist print edition

America's sharp-tongued UN envoy is struggling hard for survival, though many would gladly bid him farewell

Reuters

JOHN BOLTON, the most controversial representative ever sent by America to the United Nations, may be on his way out—or so many of his counterparts from other countries are hoping.

When he took up his job in August last year, there were instant fears that this scourge of multilateralism in general and the UN in particular was bent on lowering the organisation into its grave. Others dared to hope that a tough-talking Washington heavyweight was just what the UN needed to shake it out of its lethargy and push through unpalatable reforms. Now, as Mr Bolton struggles to keep his job, even some of his natural supporters are wondering what really drives him.

“If Bolton left tomorrow, progress would be possible on almost every front where it is now stalled,” one senior Western diplomat fumed. “He has succeeded in putting almost everyone's backs up, even among some of America's closest allies. His main achievement has been to break the unified coalition of the North and unify the previously fragmented South.” Hitherto seen as weak and divided, the UN camp known as G-77—in fact, a loose grouping of 131 developing or “southern” nations plus China—has begun flexing its muscles and speaking with one voice.

Earlier this year Kofi Annan, the UN's secretary-general, spoke worriedly about the “poisonous” atmosphere that had developed between North and South as Mr Bolton sought to force through essential UN management reforms by the power of the purse. A full-blown crisis was averted only when America, which contributes 22% of the UN's budget, and other big donors abandoned their bid to re-impose a cap on UN spending just before funds ran out in June. But it left a bad taste, especially after what many developing countries saw as Mr Bolton's bullying tactics in last year's negotiations over a wide-ranging set of proposals to overhaul every aspect of the UN, drawn up by Mr Annan. The ambassador's insistence on hundreds of last-minute amendments brought a flood of counter-proposals from a group of middle-income developing countries, including Pakistan, Iran, Cuba, Syria and Venezuela. The final “Outcome Document” from last year's summit was a pale shadow of Mr Annan's bold blueprint.

North-South relations in the UN are now worse than at any time since the first oil shock in the mid-1970s. Indeed, many see this deadlock as the biggest problem now facing the organisation. Mr Bolton

has accused the G-77 of paralysing reform. But Dumisani Kumalo, the group's current (South African) head, insists that developing nations don't oppose necessary change. In many ways, they are keener than anyone to see a more efficient, stronger world body: “Without the UN, we would be at the mercy of the big powers.”

But there is a deep lack of trust. The G-77 now sees everything through the distorting prism of the North-South divide. As Mark Malloch Brown, the UN's British and supposedly pro-Washington deputy secretary-general, noted in a speech in New York this summer, even moderate countries now suspect that “anything the United States supports must have a secret agenda aimed either at subordinating multilateral processes to Washington's ends or weakening the institutions” and “should be opposed without any real discussion”. Describing that speech as “a very, very grave mistake”, Mr Bolton demanded that Mr Annan disavow his deputy. Mr Annan declined, and instead endorsed Mr Malloch Brown's call for more effective American leadership.

Not everything about Mr Bolton is viewed in a negative light. Many observers of the UN share his criticism of its appalling waste, mismanagement, and costly ineffectiveness. His ideas for reform are often sensible, such as rationalising the overlapping functions of different UN departments and agencies, and selecting officials on merit rather than by country of origin. And even foes admire his intelligence, wit and energy. But his rigidity, coupled with an abrasive arrogance, has been counter-productive. “The big problem with Bolton,” says one formerly well-disposed UN official, “is not what he's trying to achieve, but his style. It is extraordinary how badly he has served American interests. To be embraced by America is now seen as a kiss of death.”

Still, far from shunning the UN, America seems increasingly eager to work through it to solve problems in North Korea, Iran, Lebanon and Darfur. Indeed, Carlos Lopes, Mr Annan's chief political adviser, talks of a veritable “revolution” in Washington's stance toward the UN since the invasion of Iraq in 2003. Whether this is due to, or in spite of, America's current ambassador, he is not prepared to say.

In the face of fierce opposition from Democrats and even some Republicans to Mr Bolton's original nomination last year, Mr Bush had to push through his nomination as a temporary “recess appointment” while Congress was on its summer holidays. That mandate is due to expire when the outgoing Congress adjourns, probably toward the end of the year.

Insisting that Mr Bolton is doing a “splendid job”, the White House last week resubmitted his nomination to the Senate for confirmation. But the Democrats, backed by a key Republican senator, have again vowed to block it. As a further (paid) appointment is banned by law, Mr Bush is now looking for an alternative way to save his beleaguered ambassador, possibly by naming him “acting” ambassador. Mr Bolton may be around the UN for a bit longer, for better or worse.

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War crimes

Double whammy

Nov 16th 2006
From The Economist print edition

No rest for the (allegedly) wicked

POOR Donald Rumsfeld. No sooner was he forced to step down last week as American defence secretary following Republican losses in the mid-term elections than others began baying for his blood. On November 14th a group of civil-rights and legal organisations formally requested Germany's federal prosecutor to investigate him and 11 other former high-ranking American officials for possible war crimes arising from the alleged torture of detainees in Guantánamo Bay and Abu Ghraib.

The suit was filed on behalf of 11 Iraqis and one Guantánamo detainee, under Germany's law of "universal jurisdiction". This allows the prosecution of war crimes no matter what the nationality of the perpetrator or where the crimes were committed. The suit alleges that the 12 defendants, including Alberto Gonzales, America's attorney-general, ordered or aided and abetted war crimes, or "failed as civilian superiors or military commanders to prevent their commission by subordinates or to punish their subordinates".

More than 100 countries now have some form of universal jurisdiction, including Britain, Belgium, Spain, France, Germany and Canada. Several prosecutions have been brought under such laws over the past few years, including cases against Ariel Sharon, former Israeli prime minister, and Henry Kissinger, former American secretary of state. Although several small fry have been caught, all the big fish have so far got away—as Mr Rumsfeld and his co-defendants are also likely to do.

That is not to say it is not worth trying to bring such cases. Although Spain failed in its attempt to bring Augusto Pinochet, the former Chilean dictator, to court in 1998, the case had a big legal impact, encouraging others to go after foreigners in high places. But, says Richard Dicker of Human Rights Watch, such actions must be responsibly brought, otherwise they risk discrediting the law.

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Organ transplants

Your part or mine?

Nov 16th 2006
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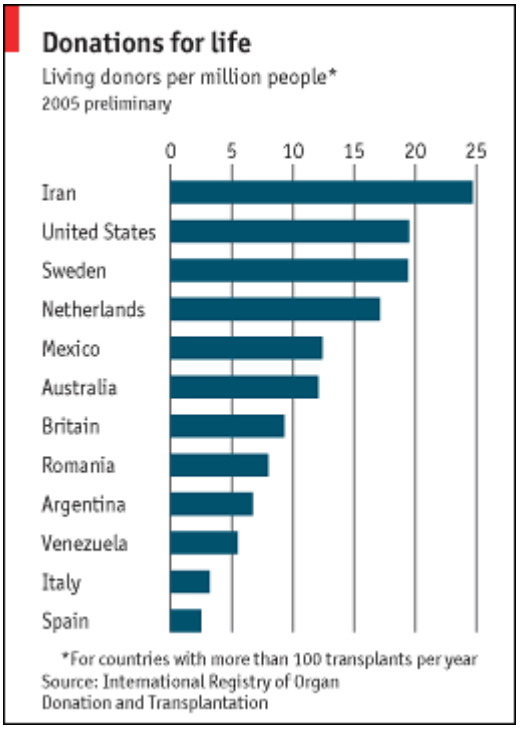
Iran's example, and the broader case for making it worthwhile to give kidneys



AS MARKETS in human organs go, the one which flourishes on Tehran's Vali Asr street, where Iran's main transplant hospital is located, is not the cruellest—and there is no lack of people willing to discuss their transactions. Gholamreza, a 44-year-old man from northern Iran, explains what he did when his dialysis started to fail. “I put an advertisement in the paper for a kidney, and a donor came straight to me. We reached an agreement on the price quite quickly. In these cases, the recipient usually takes care of the donor afterwards. So I still visit my donor and help him out.”

Another man wandering round the district, aged around 30 and wearing torn, cheap clothing, is hoping he can find a buyer as decent as Gholamreza claims to be. He expects to get between $3,000 and $4,000 for one of his kidneys. “I need the money because I lost out in a pyramid investment scam. After the operation I won't be able to lift heavy things, but I can still live with only one kidney.”

Iran's Association of Kidney Patients, a non-government organisation which obviously enjoys official favour, is responsible for all legal kidney transplants: it insists that commercial deals are the exception, not the rule. For one thing, it says, the religious authorities encourage voluntary gifts: in other words, cases where a patient receives a kidney freely offered by a friend or relative. Pious Muslims may also offer up a kidney to anyone who needs it.

With 27,000 road deaths a year, Iran has a tragically plentiful supply of young corpses, the association adds. “We're against kidney sales, we discourage them,” says Daryush Arman, its deputy head. But in practice, lots of “bargains” take place; in other words, recipients top up the $1,200 that the association pays all donors.

Although there is little information on how donors ultimately fare, Iran can claim to have solved a problem which in most Western countries is growing more acute: a rapid increase in the number of people whose lives could be extended, or improved in quality, by kidney transplants—and a failure of the supply of kidneys to keep pace. In America, the average waiting time for a kidney is now five years, up from less than a year in the 1980s. In Britain, there are around 6,000 people who need a transplant—and less than 2,000 such operations take place a year.

Some countries—Spain, Austria, Belgium and Singapore—have tried to increase the supply of kidneys and other body parts by passing laws that authorise the re-use of organs from dead bodies unless the individuals, or their families, have made formal objections. But even in those places, waiting-lists have not disappeared.

For surgeons, patients and medical economists alike, the shortage of kidneys seems frustrating, because no organ lends itself better to transplant. As long as they receive decent after-care, kidney donors suffer only the tiniest increase in their own risk of dying of kidney disease. And transplants make economic sense: the cost of one kidney operation and a lifetime's supply of anti-rejection drugs equals that of three years' dialysis. Kidneys donated by a living person last for a median 22 years in another body;

when they are taken from a fresh corpse, the figure is 14 years.

Whatever solution they propose to the shortage of kidneys, nobody doubts that the black market, as it now works, has grotesque effects, both for donors and recipients. Rich westerners who go to South Asia or Africa in search of kidneys often receive organs that are diseased or unsuitable.

Fresh details of a huge, illegal kidney-trading operation—in which poor Brazilians were brought to Durban where their kidneys were transferred to paying customers, mostly Israelis—may well emerge from a forthcoming trial in South Africa. Ilan Perry, a Israeli businessman, has been charged with masterminding a syndicate that arranged at least 100 illegal kidney swaps at a top Durban hospital. Senior medical staff there have been accused of fraud, assault and trading illegally in human organs. Their trial was halted during the summer because a key suspect was missing; the arrest of Mr Perry, who is now in Germany awaiting possible extradition, may allow proceedings to restart.

Nancy Scheper-Hughes, an American professor of medical anthropology and campaigner against organ trading, says the way poor Brazilians were induced to travel to South Africa is typical of the abuses a market in body parts, especially an international one, is bound to cause. She says donors in the Brazilian slums were given false promises about the money they would make, the care they would receive and the after-effects of the operation.

Some senior figures in the medical world draw a different conclusion: as long as some people are determined to obtain kidneys and others are desperate enough to sell them, the trade will be impossible to stop—so it makes better sense to regulate the business than drive it underground.

In Canada, where 4,000 people are waiting for organ transplants and some go to India or the Philippines in the hope of buying body parts, one specialist argues that a regulated system of compensation poses fewer problems than an illicit trade. “If you have buying and selling taking place in a country, and you can't stop it, then it's immoral not to regulate the trade, since so much harm occurs in a black market,” says Abdallah Daar of the University of Toronto, who has visited Iran and thinks it may have lessons for others.

As a member of what America calls the “axis of evil”, Iran is not often held up as a model in the West. But its approach to a desperate, and growing, medical need may yet find some imitators.

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The yachting craze

A dash for the deep blue sea

Nov 16th 2006
From The Economist print edition

Every inch of the world's coast is sized up by seafarers in search of space

IN THE waters once plied by the warships and merchants of ancient Rome, Greece and Egypt, there is a new breed of seafarers whose only aim is recreation.

Port Ghalib, on Egypt's Red Sea, is being promoted as the latest answer to the dreams of cruising sailors; a marina is the main feature of a tourist development that will occupy many miles of coast. And several other places are jostling to become the haven of choice for a rich boating set which has been everywhere else. Montenegro, which gained independence in May, has signed a privatisation deal with a Canadian entrepreneur who plans to convert a naval shipyard into a berth for big yachts. Even Libya is piling in: it plans a new resort with 150 boat slips.

The world's marinas are booming, driven by a surge in yacht sales. Boat builders are floating on a tide of orders, with luxury super-yachts showing the biggest rises. Sales of these giants—some now stretch to 400 feet (120 metres)—are up 80% in the past six years, with Russian buyers especially visible, according to the magazine *Boat International*. New Zealand, a country known for bespoke luxurious vessels, predicts that its boat sales will double by 2020, to $3.2 billion. In Finland, another boat-making hub, sales rose 35% last year.

More boats create demand for more places to park them. But waterfront is in short supply, particularly in rich countries where ecologists and surfers fight to protect the coast. And it can take more than a decade to develop a new marina. So even in parts of America, which has more than 12,000 marinas, queues are growing. Congestion is especially acute in Florida, although it has more than 70,000 slips. In parts of the Mediterranean, meanwhile, “unless you're at the marina by 2 o'clock, you get no berth,” says Ian Barker of Britain's Cruising Association.

This premium on space makes for a feverish and volatile market. Marina owners are charging higher fees and offering a broader range of facilities. But boat owners, unlike the owners of holiday villas, can instantly take off for cheaper places.

It now costs about £6,900 ($13,115) a year to keep a 33-foot boat in a popular marina in the south of England, up from £4,000 a couple of years ago. This hike in fees has driven some cost-conscious boat owners to cheaper spots in northern France. Inevitably, governments see yachting enthusiasts as a tantalising source of income. In America, recreational sailors spent about $37.3 billion last year, up 13% from 2004. In Europe, the market looks juicier still: annual spending by amateur boat owners is about $47 billion.

Among the baits governments are trying out are free moorings (the Netherlands), tax breaks for crew (New Zealand) and tax-free boat registration (Gibraltar). A few places have tripped up in their haste to take advantage of rich seafarers: Sardinia imposed a luxury tax earlier this year, but the move drove some big boats away.

As the craze for yachting spreads round the world, a new pack of countries will soon be providing talented mariners as well as attractive havens. Dubai, China and India have all seen a surge in the popularity of boating. South Africa has also seen a jump in sailing interest thanks to *Shosholoza*, its entry for the forthcoming America's Cup yacht race. With its mixed-race crew, this spectacular (but fairly low-budget) vessel will be seen by some people as a welcome reminder that in the harsh school of the sea, wealth and rank are not the only things that count.

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Time to wake up

Nov 16th 2006
From The Economist print edition

Mexico's new president, Felipe Calderón (right), must resume reforms and set the economy free—or risk backsliding, says Michael Reid

AP

"WAKE up, wake up, my dear, the dawn has broken, the birds are singing and the moon has set." Thus go the lyrics of Las Mañanitas, the Mexican equivalent of Happy Birthday, belted out every day in restaurants and homes across the country, often by troupes of *mariachi* musicians in full regalia. The verse seemed particularly appropriate as Mexico celebrated its 196th birthday on September 15th—the anniversary of the day when Miguel Hidalgo, a parish priest, called for independence from Spanish colonial rule. Mexico gives every impression of sleeping while the world changes around it. Having seemed to embrace globalisation—favoured by its geography, on the doorstep of the world's largest consumer market—the country risks slipping back into internecine conflict and introversion.

Six years ago the election as president of Vicente Fox (pictured left) completed a long transition to democracy, ending 72 years of authoritarian rule under the Institutional Revolutionary Party (PRI). It also seemed to set the seal on the economic modernisation of the world's largest Spanish-speaking country, with a population of 106m. After Mexico went bankrupt in the debt crisis of 1982, the last three PRI presidents cast aside protectionism and state capitalism, most notably Carlos Salinas (in office 1988-94), who led his country into the North American Free-Trade Agreement (NAFTA) with the United States and Canada. Mr Fox, a former head of Coca-Cola's Mexican operations, pledged further economic liberalisation and reform.

Mr Fox's government can look back on a number of achievements for which his many domestic critics give him insufficient credit. In recent years the country has enjoyed greater political freedom than perhaps at any other time in its history. The government has maintained economic and financial stability, with inflation for this year estimated at 3.7%. Easier bank credit, together with a vast housebuilding programme promoted by the government, is slowly bringing tangible benefits to an expanding middle class. Social policies have helped to cut poverty.

Asleep in a hammock of oil

Even so, many of the hopes raised by Mr Fox were dashed. He lacked a majority in Congress and proved unable to win approval for any big reforms. Instead of the annual growth of 7% he had promised, the economy has limped along at an average of just 2.5% since 2000. The government's finances look better than they are, helped by extra oil revenues equal to 2% of GDP. "Fox has fallen asleep in a hammock of

oil money," says Liébano Sáenz, who was chief of staff to Ernesto Zedillo, the last of the PRI presidents (1994-2000).

Labour productivity is low and growing only slowly. Oil apart, Mexico's exports to the United States are losing market share to China's. Some of the social policies have reduced the incentive for millions of small businesses to put themselves on a proper legal footing. That is only one symptom of a wider absence of the rule of law. Another is mounting violence from drug gangs.

AP

The president they did not get

As Mr Fox's term draws to its close, Mexico is starting to look like two different countries. Thanks in large part to NAFTA, much of the north is making visible progress. By contrast, the populous south remains locked in poverty, backwardness and neglect. Meanwhile, each year some 500,000 or so young Mexicans cross the country's northern border to the United States in search of a better life.

On top of all this, Mexico's politics have suddenly become much more complicated and confrontational. The campaign ahead of the presidential election on July 2nd was dominated by Andrés Manuel López Obrador. As mayor of Mexico City, he had made himself popular by providing pensions for the elderly and public works. Standing for a centre-left coalition, he took his fiery oratory to the public plaza in a country where politics has long been dominated by backroom deals. But he was pipped at the post by Felipe Calderón, the candidate of Mr Fox's conservative National Action Party (PAN). Mr Calderón won 35.9% of the vote against Mr López Obrador's 35.3%, a margin of just 233,831 votes out of almost 42m. The PRI's Roberto Madrazo polled a meagre 22.2%.

To many Mexicans, the election appeared to highlight their country's divisions and to call its growing globalisation into question. Mr López Obrador spent his formative years in the PRI. He left it in the late 1980s when the economic nationalists in the party lost out to the free-market technocrats. Though many of his economic policies were mild enough, he inveighed strongly against poverty and privilege. To his detractors, he seemed to stand for a return to the authoritarian populism practised by the PRI in the 1970s. Nothing in his life suggested any interest in or knowledge of the world beyond Mexico.

Apart from one brief wobble, in the run-up to the election Mr López Obrador was always ahead in the opinion polls. But he made mistakes, insulting Mr Fox and staying away from the first of two campaign debates. Some of the economic policies he proclaimed stirred fears of a return to financial instability. He was also the target of a smear campaign. Mr Calderón dubbed him "a danger to Mexico", comparing him to Venezuela's populist president, Hugo Chávez. Mr Fox, along with Mexico's richest businessmen, weighed in on Mr Calderón's behalf.

So when the vote unexpectedly went against him, Mr López Obrador and his backers felt robbed. They cried fraud, though they never produced any convincing evidence, and called for "civil resistance" against the electoral authorities. For seven weeks the beaten candidate's supporters camped out in the centre of Mexico City, occupying the Zócalo, the great square that has been the heart of the city since Aztec times, and blocking Reforma, its grandest avenue. "To hell with your institutions," declared Mr López Obrador.

Even the independence celebration on September 15th was overshadowed by the post-election conflict. Mr Fox chose to mark the occasion in his (and Hidalgo's) home state, leaving the traditional venue, the Zócalo, to Mr López Obrador's people for the evening. After a final rally of his supporters at which he vowed to proclaim himself the "legitimate president", Mr López Obrador suspended his protests. But he said he would not recognise Mr Calderón when the new president formally takes over on December 1st.

Crying foul

In “The Labyrinth of Solitude”, his classic study of the Mexican character, Octavio Paz noted that his countrymen habitually mask painful realities, hiding more than they reveal. Mr López Obrador's claim to be leading a mass social movement for democracy against a “usurper”, Mr Calderón, fits in with that tradition. Mr López Obrador recalled a long history of electoral fraud under the PRI. He drew a particular parallel with 1988, when Mr Salinas was declared president after the computers counting the votes had “crashed” while showing an early lead for his leftist challenger, Cuauhtémoc Cárdenas.

The parallel was askew. In 1988 the electoral authority was the Minister of the Interior. But a decade ago, with the agreement of all the parties, Mexico set up independent electoral institutions. According to those independent bodies, two counts of the ballots (and a partial recount of 9% of them) all showed the same narrow lead for Mr Calderón. The election produced the best-ever haul of congressmen for Mr López Obrador's centre-left Party of the Democratic Revolution (PRD). The electoral tribunal did find that the interventions of Mr Fox and the business groups were technical violations of the electoral law, but no other democracy would worry about such things.

Most of the people camped on Reforma, far from constituting an independent social movement, were cogs in the political machine built by the former mayor. The protest had the backing of the Mexico City government. “It's not the people v the powers that be. It is the powers that be,” quipped Jorge Castañeda, a political scientist who was the first foreign minister in Mr Fox's government.

The biggest irony of all is that as former members of the PRI, several of Mr López Obrador's closest collaborators were complicit in the fraudulent campaigns of the past. The protests were “the rebellion the PRI didn't do in 2000” when it lost power to Mr Fox, says Héctor Aguilar Camín, a historian. “Alternation in power had happened very cheaply for us. It's the first protest against this young democracy, done by the ex-Priistas of the PRD.”

Mr López Obrador's attempt to emulate Evo Morales, the Bolivian president who toppled two predecessors by organising street demonstrations, seems to have backfired. Polls show that if the election were held today, Mr Calderón would win by a comfortable margin. On October 15th the PRD lost a gubernatorial election in Mr López Obrador's home state of Tabasco even though he went to campaign for his party.

All that said, Mr López Obrador's campaign laid bare many Mexicans' deep sense of dissatisfaction with the status quo. And Mr Calderón, having won the narrowest of victories, has had to rearrange his priorities. He now lists these as job creation, the fight against poverty and public security; at the start of the campaign they came in the reverse order. “Pragmatically, I'm interested in winning over a part of the electorate that wasn't with me and whose concerns were much more centred on poverty,” he said in an interview for this survey.

The first question raised by the election and its messy aftermath is whether Mr Calderón can govern Mexico. The second is whether he can restore it to a path of democratic progress and rapid economic growth. This survey will argue that, contrary to appearances, he has an extraordinary opportunity to do both—but only by being far bolder than his predecessor in tackling the many vestiges of the old order that are still holding the country back. Many of these involve monopoly power, public and private, political and economic. They cover a broad range: from the teachers' union to Pemex, the state oil monopoly, and Telmex, a private telecoms near-monopoly. It is these bastions of unaccountable power, rather than Mr López Obrador's antics, that are the real threat to Mr Calderón's government and to Mexico as a whole.

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Pregnant pause

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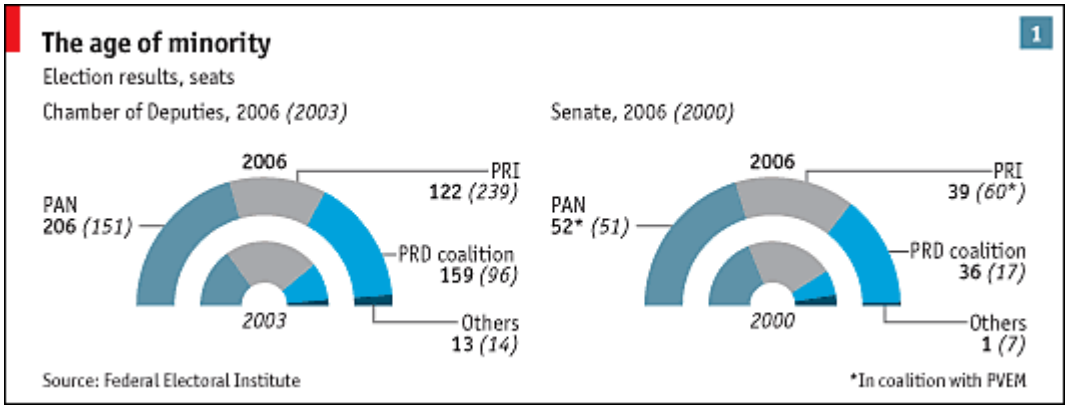
From The Economist print edition

The old political model has died; a new one has yet to be born

DEMOCRACY did not come easily to Mexico. Whereas most South American countries nurtured a democratic tradition through their swings between dictatorship and civilian rule, Mexico over the past two centuries has seen long periods of authoritarian government punctuated by three civil wars. The one brief interlude of liberal government came in the mid-19th century, under Benito Juárez, a Zapotec Indian and elected president—a period known as *la reforma* and commemorated in the avenue of that name. The last and bloodiest of the civil wars was the Mexican revolution of 1910-17 (some historians argue that it did not end until 1940). It began as a crusade for liberal democracy, under the cry of "Effective Suffrage, No to Re-election", but ended up with the corporate state run by the PRI.

The blocking of Reforma for seven long weeks was an apt metaphor for Mexico's condition over the past decade. Transforming an inward-looking corporate state into a liberal democracy with an outward-looking market economy was never going to be straightforward. Besides, Mr Salinas's bold economic reforms in the early 1990s were meant to give new life to the PRI system rather than end it—and some were less liberal than they looked. Just as NAFTA came into effect in 1994, the semblance of political order was shattered first by the short-lived uprising by the Zapatista rebels, led by Subcomandante Marcos, a ski-masked Marxist philosopher; and then by the (still unresolved) murder of Mr Salinas's hand-picked successor, Luis Donaldo Colosio. Shortly afterwards, just as Mr Zedillo took over from Mr Salinas, the peso collapsed and the banking system with it.

The subsequent deep recession undermined public support for market reforms, which had included privatisations as well as NAFTA membership. As a result, the PRI lost its majority in Congress in 1997. Mexican politics has seemed close to gridlock ever since. Where there was one dominant party there are now three, none of which can command a majority (see chart 1). The deeper reason for Mexico's political paralysis is that is has yet to replace many of the institutions of one-party rule.



One reason why the PRI regime was so durable was that it used coercion only as a last resort. Wherever possible it preferred to buy loyalty, be it of professors or peasants, with state largesse or the selective application of laws. Contrary to the revolution's rallying cry, suffrage was not effective and fraud was common. But by honouring the principle of no re-election the PRI ensured regular changes of leadership, and with it the flexibility to move left or right. On paper under the 1917 constitution the presidency was rather weak. In practice it was omnipotent.

But Mr Fox, the first non-PRI president for more than seven decades, had only his paper powers to rely on. He seemed an ideal candidate: thick-skinned, determined, bluffly charming and a natural media performer. But he has been a disappointing president. He "never understood the nature of presidential authority...he confused leadership with popularity as if he were a film actor, and he didn't know how to

negotiate politically," says Enrique Krauze, a historian.

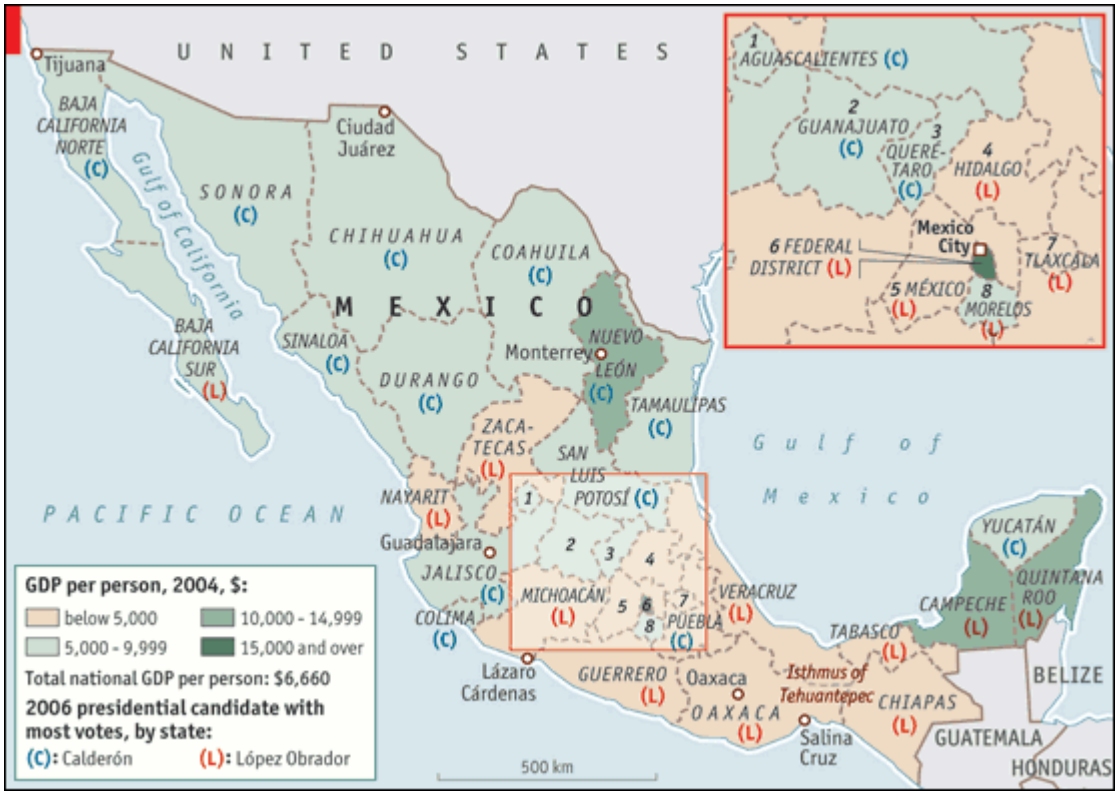
Certainly he was naive in allowing Marta Sahagún, his ambitious former press secretary and second wife, to give the appearance of sharing presidential power. And his approach to reform was far too laid-back: ignoring his party's congressional caucus, led for a time by Mr Calderón, he seemed to think his job was done merely by sending a bill to the legislature. Wags say he has a "Montessori cabinet" because each minister does his own thing.

He also shrank from applying the law where protests went beyond it. Early in his presidency his authority was terminally undermined when he permitted a few thousand machete-wielding far-left demonstrators to kill off a plan for a new airport for Mexico City. Mr Fox himself counters this last criticism by saying that it comes "from those who yearn for the old authoritarian presidentialism". Maybe so. Yet whether in land-use planning or the policing of protests, Mexico finds itself in limbo. The old ways of presidential diktat no longer work, but new ways based on consultation, consensus and the exercise of democratic authority have yet to be created. Into this vacuum Mr López Obrador defiantly stepped in the weeks after July 2nd.

Governing from the centre

To all appearances, Mr Calderón faces a much more difficult task than his predecessor. His mandate is narrower, and his legitimacy is questioned by a substantial minority of Mexicans. Where Mr Fox could count on a "democracy dividend", Mr Calderón is faced with demands that democracy deliver swift and tangible improvements, according to Miguel Székely, who has advised both men on social policy.

But Mr Calderón also has several advantages. Unlike Mr Fox, who came to politics late in life, he is a professional politician and a party man. He was born into the National Action Party, of which his father was a local official. He is a lawyer with technocratic know-how, having studied economics and, at Harvard, public administration. Aged only 44, he has had little administrative experience—he was Mr Fox's energy minister for just nine months before resigning to stand against the president's nominee to be his party's presidential candidate. But he has plenty of experience of Congress, which may count for more. A liberal on economics and a moderate conservative on social matters, he is a pragmatist and a skilled negotiator. "I must be a president who seeks the political centre," he said in victory.



To secure a congressional majority, to which he is closer than Mr Fox, he has offered to lead a coalition government. But Mexico has no experience of formal coalitions. What Mr Calderón is working on, he says, is a "common agenda" with other parties. He is also likely to offer several ministries to people with ties to

the PRI.

Much will depend on the PRI's attitude. Though Mr Madrazo, its presidential candidate, suffered a humiliating defeat, the party still governs 17 states (against nine held by the PAN and six by the PRD). These days most of its members are closer in their instincts to Mr López Obrador than to Mr Calderón. But the PRI is evolving into an alliance of powerful regional barons. Several important figures in the party stress that Mexico needs reforms. “There are very professional politicians in the PRI who understand that the country needs changes,” says Luis Téllez, who was energy minister under Mr Zedillo and is tipped for a job in Mr Calderón's cabinet.

Several pending structural reforms—for example in energy supply, trade unions, the labour market and the police—will require constitutional changes that call for a two-thirds majority (as well as the backing of a majority of state legislatures). This will be hard to muster without the support of at least part of the PRD. That is not out of the question. Even as Mr López Obrador was denouncing the country's institutions, many PRD leaders were quietly operating within them, in Congress and in the party's state governments. Several of those leaders, including Mr Cárdenas, have more or less openly distanced themselves from Mr López Obrador. Jésus Ortega, a senior figure in the PRD, talks of using Congress to introduce political reforms, a “change of economic model” to one of “stability with growth”, a tax reform and measures against corruption.

None of this is unbridgeably distant from the proposals put forward by Mr Calderón himself. Unlike Mr Fox, he speaks of the central place of Congress in making policy. That is to recognise reality. Jeffrey Weldon, a political scientist at ITAM, a Mexico City university, points out that more than 70% of the 824 measures approved in the legislature in the past three years were proposed by the legislators rather than by the government, against fewer than one-third under Mr Salinas.

Power has rapidly seeped away from the presidency—to governors, mayors, party leaders and the media as well as Congress. That may be a good thing, but there are no rules to encourage collaboration between these different actors. Many political scientists think that this new pluralism would be better served by a parliamentary system than a presidential one. But Mexico has been accustomed to a powerful figure at the top since Aztec days.

More accountability

A better option might be to help the president mobilise majorities and give him some tools to negotiate with Congress. For example, Congress could be required to deal with a bill proposed by the government within a given time limit. When no candidate in a presidential election wins outright, the introduction of a run-off ballot would strengthen the victor's mandate. That could be balanced by a shorter term of office. For its part, Congress would become more accountable if legislators were able to stand for immediate re-election. There is support in all three parties for a change that would allow senators two consecutive terms (12 years in all) and deputies three (nine years).

More needs to be done to bring accountability and openness to politics at all levels. Mr Fox, impelled by a media campaign, pushed through a freedom-of-information law. “It's very imperfect, but even so it's a leap forward of 50 years,” says Alejandro Junco, a newspaper publisher who led the campaign. Congress, however, remains a closed book: votes are secret, assets do not have to be declared and there are no rules for resolving conflicts of interest. “I can know what the president's towels cost but not what my congressman does,” Mr Sáenz says.

The same goes for many state governments. Some are models of reform, others are throwbacks to the old regime. Take Oaxaca, in the south, where the PRI has never lost power. In 2004 Ulises Ruiz, the PRI candidate, only narrowly won an election for state governor. His opponent's claim of fraud was better-founded than Mr López Obrador's, because in Oaxaca the PRI controls the local electoral authority. His opponents accuse Mr Ruiz of funnelling state money to his party's presidential campaign. In May, teachers in the state began an indefinite strike. This quickly turned into a quasi-insurrection in the state's capital, aimed at ousting Mr Ruiz. The city's tourist industry has collapsed. In late October, after a total of 17 people had been killed, Mr Fox sent the federal police to retake the city centre from the protestors.

This stand-off is a special case, but in many ways Oaxaca exemplifies the problems of southern Mexico, which voted heavily for Mr López Obrador.

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Mexico's mezzogiorno

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What is needed to bridge the gaping north-south divide

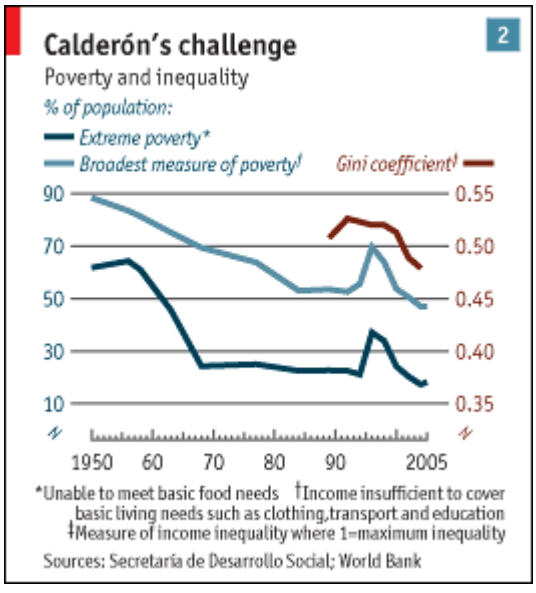
SANTIAGO TLAZOYALTEPEC is less than two hours' drive from the city of Oaxaca, up a precipitous dirt road flanked by cool forests of pine and evergreen oak. It is one of the 570 separate municipalities contained within the state of Oaxaca, a corrugated land of forested mountains and brown rivers. Like many of the settlements established by the Mixtec (meaning “people of the clouds”), Tlazoyaltepec straggles along the tops of sinuous mountain ridges: a clutch of separate ribbon villages with a total population of some 10,000 people. The world owes the domestication of the turkey to the Mixtecs. But today they scratch a living from small *milpas* (maize fields). Ask how things are going, and the answer is a repetitive lament: *No hay trabajo* (there's no work).

Even so, people are living a little better nowadays, concedes Panfilo Santiago, the municipal councillor in charge of education, his Spanish delivered in a thick Mixtec accent. The first reason is that many of them have gone north, to the United States or to work in the tomato fields of Baja California. They either return richer or send back money. The Inter-American Development Bank estimates that remittances from Mexicans abroad will total $24 billion this year, about a third more than the flow of foreign direct investment. The relative prosperity of such families is displayed in the status symbols of the Mixtec highlands: a big Ford or Chevrolet pick-up parked outside the door and, increasingly, a two-storey concrete house in place of a wooden shack.

The second reason why people are better off is a means-tested anti-poverty programme, pioneered by Mr Zedillo's government and expanded and renamed Oportunidades by Mr Fox. It pays mothers a monthly allowance provided they keep their children in school and take them for regular health checks. In Tlazoyaltepec, around 70% of families receive help from Oportunidades, says Mr Santiago.

Across Mexico Oportunidades helps some 5m families (or around a quarter of the total) at a cost of $2 billion a year. While alleviating poverty, the programme's main aim is to prevent it in the next generation. The idea is to expedite Mexico's transition to a labour force that has finished secondary school, says Santiago Levy, who as a finance official in Mr Zedillo's government invented the programme.

Thanks to remittances and Oportunidades, extreme poverty has declined under Mr Fox, despite mediocre economic growth (see chart 2). But as in many other Latin American countries, income distribution in Mexico has long been extremely unequal. “Perhaps nowhere is inequality more shocking,” noted Alexander von Humboldt, an aristocratic German scientist and traveller, in his essay on colonial Mexico published back in 1811. Despite the protestations of many critics of the economic reforms, income inequality now is no greater than it was 20 years ago, but regional differences are becoming increasingly marked. “There is one Mexico more like North America and another Mexico more like Central America,” is how Mr Calderón puts it. “It is a very clear challenge for me to make them more alike.”

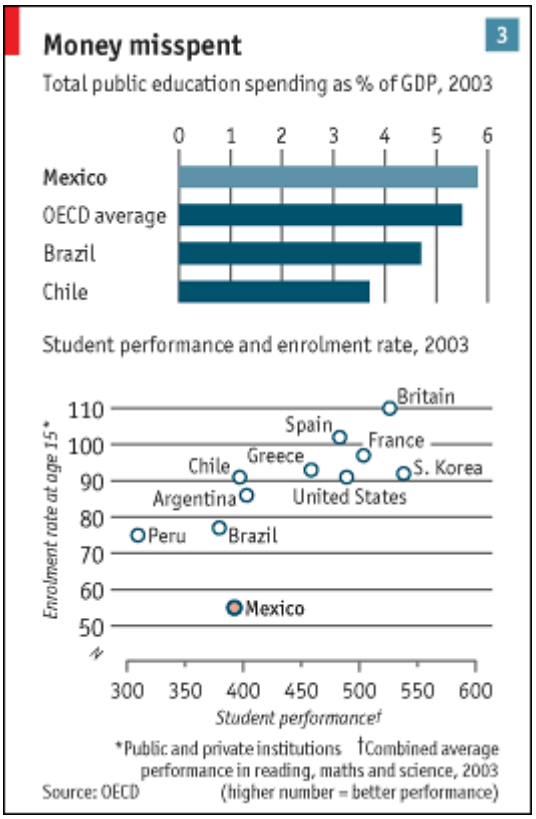


Official figures show that one Mexican in two still lives in some degree of poverty; in much of the south that figure rises to three in four. For most of the past century southern Mexico has been worse off than the north, but NAFTA is helping to widen the gap. Average growth since 1995 in many northern states has been running at 4-5%; in most of the south and centre it has been more like 1-2%.

Southern cross

The nine states of the south and south-east account for almost a quarter of Mexico's total area and population. They are more rural, more Indian and poorer than the rest of the country. Almost 45% of their population live in settlements of under 2,500 people, compared with 20% elsewhere. Twice as many people lack electricity and piped water, and half as many can read and write. Much of the south is afflicted by poor schooling, poor communications, lack of investment and, often, reactionary political leadership.

Successive governments have made a big effort to get children into education. Since 1960 the number of years the average Mexican child spends at school has gone up from 2.6 to nearly eight. But that still means some 35m adults have failed to complete the nine years of basic primary and lower secondary schooling. They find it hard to get decent jobs. Enrolment at upper-secondary level is lower than in many other Latin American countries (see chart 3). Moreover, the quality of schooling is poor and the education system fails to offer equality of opportunity.



Mr Zedillo's government bravely decided that Mexican children should sit international tests. Mexico came bottom of all the countries of the Organisation of Economic Co-operation and Development (OECD), the rich-country club it ambitiously joined when Mr Salinas was riding high, and did no better than Brazil and other Latin American countries, even though it spends proportionately a lot more on education.

Reclaiming the classroom

In the past much education spending was lavished on public universities because the PRI saw students and academics as an important constituency. Recent governments have spent more on schools, but nearly all of the money has gone on teachers' salaries. That is a tribute to the stranglehold the Educational Workers' Union, Latin America's largest trade union, has on Mexican education. In effect, it is the provider; the federal government merely hands out the money. Its 1.4m members include not just classroom teachers but head teachers and school inspectors too.

In practice it is the union, not head teachers, parents or state governments, that decides on the hiring and (very rarely) firing or redeployment of teachers. It resists outside evaluation of teachers, many of whom are untrained. Enrique Rueda, the leader of the Oaxaca teachers, concedes that the union has been better at pursuing salary demands than at improving schooling. “Control of bad teachers is very limited,” he says.

As education minister in Mr Salinas's government, Mr Zedillo devolved formal responsibility for schooling to the states and modernised teacher-training and textbooks. But in practice the system remains centralised: the union negotiates salaries with the federal government each year, and then its regional branches try to extract a bit extra from the states. Few decisions are taken at school level.

NOTIMEX

Not much of a future in Santiago

John Scott of CIDE, a Mexico City university, points out that only 1% of students in higher education are from the poorest 20% of the population. As things stand, echoes Miguel Limón, who was Mr Zedillo's education minister, education reproduces regional inequalities. Although coverage in the south is catching up, quality lags, partly because richer northern states top up federal funds.

Across the south other factors conspire against good schooling. Poverty is itself one reason why children drop out of school early, as the Oportunidades programme recognises. The region is home to many Mexicans of indigenous descent. At primary level 1.2m pupils receive bilingual teaching in 54 different tongues, but there are few competent bilingual teachers. And where the population is thinly scattered, as in the Mixteca, primary-school classes take in children of widely differing ages.

In Tlazoyaltepec the Velascos, a peasant family, provide an illustration of educational progress—and of the obstacles that still remain. María Elena Velasco's father had only two years of schooling and her mother none. She and her brother dropped out of secondary school after a year. She is determined that her children will do better. “I'll have to take them to the valley. Who knows how I'll do it, but I have to.” Mr Santiago, the education councillor, says the town council has asked the state government for an upper secondary school “so that the young people don't have to migrate to the United States.”

Technology may be the only way to improve rural schooling. Mr Fox speaks proudly of having put a computer into every school, opening it up to Enciclomedia, a pioneering programme of digital textbooks. The Tecnológico, a not-for-profit university based in Monterrey, is working with the government on a scheme to deliver upper-secondary schooling via the internet in 1,000 communities in the south. But in Tlazoyaltepec, as in many rural towns in the south, there is no internet connection. Rafael Rangel, the Tecnológico's rector, says the scheme's success depends on government investment in a wireless internet network.

Lessons for teachers

That leaves the question of what to do about the teachers. At present 95% of education spending goes to the producers and only 5% to the consumers in the form of scholarships. A really bold president might try to break the union's grip on the classroom by giving the money to parents in the form of vouchers. But Elba Esther Gordillo, the union's general secretary, has transferred her political support from the PRI to Mr Calderón, for whom she was an important electoral ally.

Mr Calderón insists that the only way to change education is with the union rather than against it. “The key is to introduce the right incentives,” he says. He has proposed to the union that instead of “paying more to those who press hardest, as in Oaxaca...let us pay more to those who teach better, who raise the level of their class, who prepare more and who meet required standards.” If he can get this idea past Ms Gordillo, it would be a big step forward.

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Spider in the web

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From The Economist print edition

All roads lead to Mexico City

APART from better schools and alternatives to subsistence farming, the south needs better transport links. NAFTA has made this more urgent. Mexico's crucial competitive advantage in the United States over distant countries such as China is lower transport costs. But that advantage diminishes the further south you go. Distance thus inhibits the south from taking advantage of its lower production costs. Public policy has aggravated the problem.

Most railways and roads were built in a radial pattern, with Mexico City as the spider in the centre of the web. That pattern met the needs of centralised political control and the policy of import substitution pursued until 1982. At the peak in 1970, half of the country's industrial production took place in Mexico City alone.

Goods from the south bound for the United States must pass through the bottleneck of Mexico City, climbing to 2,500 metres (8,200 feet) above sea level. What is needed is to build or to complete motorways from the south-east along the Gulf Coast to the border, and along the Pacific Coast from Chiapas to the port of Lázaro Cárdenas. Expansion of the port at Salina Cruz and the railway to it across the Isthmus of Tehuantepec would help too. Mr Levy reckons these projects would require federal investment of $2 billion-3 billion a year over the next five years. Once completed, they would cut transport costs by up to 25%, as well as boosting tourism. The plan was first proposed in the late 1990s. Mr Fox unveiled an even more ambitious scheme to improve infrastructure in southern Mexico and Central America. Not much happened, despite Mexico's oil windfall.

In 1994 a motorway from Mexico City reached the city of Oaxaca, cutting the journey time from nine hours to five. As a result Oaxaca's metropolitan area now accounts for around a third of the state's economy, up from 10% in 1994, according to José Ramón Ramírez, the rector of the local Vasconcelos University. Tourism as well as commerce has grown. But feeder roads to smaller towns—which are the responsibility of the states, not the federal government—are still lacking.

The south-east produces most of Mexico's oil and hydro-electricity, and gets most of its rainfall. But until recently the government ensured that electricity and feedstock for petrochemicals cost the same across the country. Another subsidy to the north is more explicit: that for electricity for irrigation, which costs around $450m a year (more than the country's entire main rural development programme). Fruit- and vegetable-growing is therefore concentrated in the north, even though the south is naturally better suited to it. With improved transport links, its Pacific coastal strip could export such products to California and Japan.

Mr Calderón says he is working on a huge programme of public works for the south, including a scheme to mobilise federal and international money for drinking-water and sanitation schemes. Mr Téllez suggests measures such as tax breaks for firms that set up in the south. But such remedies have been tried elsewhere, without much success. Whatever form it takes, Mexico certainly needs a regional policy for the south.

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Plodding on

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Economic stability is all very well, but where's the growth?

MR FOX had barely installed himself in Los Pinos, Mexico City's modernist presidential complex, in December 2000 when his country was dealt two blows that stopped economic growth in its tracks. The dotcom bubble burst, triggering a slowdown in industrial production on both sides of the border. And China joined the World Trade Organisation, marking the arrival of a powerful competitor to Mexico for footloose manufacturers hoping to export to the United States. Those twin blows caused three years of economic stagnation in Mexico and the loss of some 700,000 formal jobs, most of them in the *maquiladora* plants producing goods for export. Some of those jobs moved to China.

In the second half of Mr Fox's term growth has picked up. This year it is heading for 4.5%, the highest figure since 2000. In the first nine months of this year some 900,000 formal jobs were created, almost keeping pace with the growth in the labour force. That is thanks in part to higher oil prices. But it is also because the private sector has made a big effort to cut costs and regain its competitive edge, as Alfredo Thorne of JPMorgan, an investment bank, points out.

The car industry is doing especially well, with output in the first half of this year up 36% on the same period in 2005. Detroit's troubled carmakers may be closing factories in the United States, but they are quietly expanding in Mexico. So are Nissan, Toyota and Volkswagen. Mexican suppliers of car parts account for a much higher portion of the finished cars than in the past. Mexico cannot match China's cheap labour, but it can compete in higher-value goods and where transport costs are important. Many of the jobs it lost were in textiles; some of the new ones are in electronics, which now accounts for around one-fifth of the country's total exports.

There is a familiar cloud on the horizon: the economy north of the border is once again threatening to slow down. But Mexico is much better placed to weather an American recession than it was in 2000. That is because inflation is low, the public-sector deficit is close to zero and the current-account deficit is much smaller than it was six years ago. Nor is growth coming only from exports. Mexican banks are lending again.

The end of original sin

“A few years of single-digit inflation have transformed the financial markets,” says Guillermo Ortiz, governor of the Bank of Mexico, the central bank. “What's surprising is that this has happened so quickly.” Mexico's government debt began to achieve investment-grade status in 2000 with dramatic effects. In 1999 the maximum term of government bonds was one year; most were denominated in dollars or linked to inflation. In 2003 the government issued a 20-year bond in pesos; last month it launched a 30-year peso bond not indexed to the inflation rate.

So Mexico has overcome what Ricardo Hausmann, a Venezuelan economist at Harvard, dubbed “original sin”—emerging-market countries' traditional inability to borrow long-term in their own currency. Because of its relatively conservative fiscal policy, the government now absorbs only 16% of national savings, down from 80% in 2000. That has helped everyone else to borrow more cheaply. Big companies are now issuing ten-year peso bonds at a fixed rate of around 8%, according to Damian Fraser of UBS, a Swiss investment bank.

The banking system seems poised for growth, after a turbulent quarter-century that began with its nationalisation in 1982. Mr Salinas privatised it but unwisely barred foreign banks from bidding. Having lent recklessly, sometimes to insiders and/or in dollars, the banks got into difficulties when the peso plunged

and interest rates leapt in 1994-95.

But just as the bankers had benefited from lax regulation under Mr Salinas, so they received generous treatment from Mr Zedillo when they got into trouble. In effect they were allowed to pass their non-performing loans to the government, which also offered unlimited deposit insurance. In all, the bank bail-out cost the taxpayer around 20% of GDP. The Zedillo government did belatedly tighten supervision and accounting standards and lifted the ban on foreign commercial banks. Now foreign banks make up more than four-fifths of the system.

Until recently the banks did very little lending, but credit is now expanding. Mexicans are able to take out mortgages again and loan interest rates are coming down fast. Such is the boom in house construction that Cemex, Mexico's biggest cement company, in September announced its largest capacity expansion in a decade.

Consumer credit too is growing rapidly. But small and medium-sized businesses have been slower to take advantage of lower interest rates. Jaime Guardiola of Bancomer, the Mexican affiliate of Spain's BBVA, notes that although his bank has a smaller market share in its home country than it does in Mexico, in Spain it lends ten times as much to such businesses. To boost such lending in Mexico, new rules are needed to make it easier for banks to call in loan guarantees.

Eyevine

Racing against China for a share of the American market

Mr Ortiz reckons that excessive interest-rate spreads and fees dampen demand for credit. Bankers reject the criticisms. Competition is fierce and is driving down margins, says Sandy Flockhart, HSBC's managing director for Latin America.

Mr Fox's government has been markedly more effective at reforming the financial system than at dealing with its own finances. Since 1999 the public-sector borrowing requirement has fallen from 6.3% of GDP to around 2%, despite a modest increase in public spending. But the government has been helped by falling debt payments and bumper oil revenues. Oil accounts for more than a third of total government revenue. There are two problems with that. The first is that it bleeds Pemex, the national oil company, of investment funds. The second is that oil revenues are likely to fall in the coming years.

The taxman cometh

Mr Calderón will need to spend more—on infrastructure, education, health and probably on job-creation measures—if Mexico is to make the most of NAFTA, and indeed if it is to remain governable. Yet Mexico is notoriously bad at collecting taxes. Total tax revenues in 2004 (excluding oil income) amounted to only 11.4% of GDP. That is not only much less than the average for the OECD countries (36%), but also below the average for Latin America (13.7%). One reason is that large chunks of the economy—food, medicines, agriculture, fisheries and land transport—are either exempt from value-added tax or zero-

rated. The OECD estimated that the exemptions cost up to 2% of GDP in lost revenue—and also make evasion easier.

But Congress twice rejected the efforts of Mr Fox's government to broaden VAT. Mr Calderón says he wants to simplify tax rates and increase the number of taxpayers, on which Mr Fox's government has already made some progress. He names fiscal reform as one of his top two legislative priorities because it will allow him a greater margin for manoeuvre. The other priority is energy policy, one of a raft of structural reforms that Mexico's economy needs if it is to become more competitive and grow faster.

Even without reforms, the economy is not about to collapse. Growth averaging around 3.5-4% a year for the next few years may still be possible. Indeed, Francisco Gil, the finance minister, argues that Mexico could follow Spain's example. Like Mexico, Spain opened up its economy and cast off authoritarian rule. Like Mexico, Spain suffers from weak productivity but has achieved sustained economic growth by combining manufacturing exports to a large and rich neighbour with dynamic construction and tourist industries and a strong banking system.

The trouble is that Mexico needs to do better than Spain if it is to reduce poverty and raise its living standards by enough to stop its young people from leaving for the United States. Mr Ortiz says bluntly that growth is “completely insufficient. With better public policies, we could grow at 5.5-6% a year. That is the challenge. The answer is basically to make the economy more flexible.” But that will mean tackling some powerful vested interests.

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Monopoly money

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Competition is not Mexico's strongest point

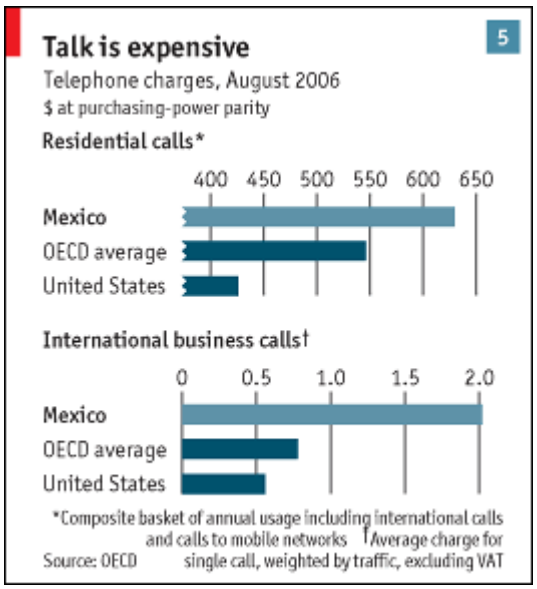
AP

There's no stopping Slim

THE most powerful man in Mexico is not Mr Calderón, nor Mr López Obrador. It is Carlos Slim, the world's third-richest individual, with a net worth put by *Forbes* magazine at $30 billion (the equivalent of 3.7% of Mexico's GDP). His tentacles extend across large swathes of the economy. At their head is Telmex, the telecoms company privatised by Mr Salinas in 1990, of which Mr Slim's family holds 48% of the capital and 71% of the voting shares. The cash from Telmex has financed relentless diversification. Mr Slim's América Móvil is the largest mobile-phone operator in Latin America. His family also holds a string of industrial and retailing businesses, including the Mexican operations of Sears. He is the biggest tenant in the country's shopping centres. His latest venture is Ideal, an infrastructure company working mainly in the oil industry. He is also the second-largest shareholder in Televisa, Mexico's dominant media business. What distinguishes him from Bill Gates and Warren Buffet, the only two men richer than him, is the parsimony of his philanthropy.

There is no doubting the business acumen of Mr Slim. His defenders portray him as a national champion and a bulwark against foreign (probably American) control of the economy. But he has had a lot of help from the government.

As with the banks, Mr Salinas privatised Telmex badly: the new owners were granted an outright monopoly for six years. Since then the market has been open. Several competitors have poured billions of dollars into rival networks. So why does Telmex still have 94% of landlines, 78% of mobile services and 70% of the broadband internet market? That question is all the more pertinent because telecoms costs in Mexico, though falling, remain above the international average (see chart 5). Mexico also has fewer phones per person than any other OECD country or Brazil, which privatised eight years later but encouraged competition.



The answer is that Telmex still exercises significant monopoly power. Its competitors tell a Kafkaesque tale of regulatory capture. Pedro Cerisola, the minister of transport and communications, was a Telmex manager of long standing, and one of his deputies is a former manager of Televisa. In breach of its legal duties, the ministry has dragged its feet in approving licences for would-be competitors and shown Telmex their business plans. Telmex has repeatedly used the courts to block or delay regulatory rulings telling it to cut its prices. If Mexico were the United States, Telmex would have been broken up years ago.

But Mexico is Mexico. Telmex is merely one of the more egregious examples of the widespread rule of oligopoly. An ordinary citizen who wants to import and distribute beer, cement, textiles or bread will soon find that he cannot do so. In the midst of the election campaign, Congress approved a law giving free wireless spectrum to Televisa and its only rival, TV Azteca. Only in the airline industry has there been timid progress: Mexicana and Aéromexico have been de-merged, and two tiny low-cost ventures have started up.

“Mexico lacks a competition culture,” says the OECD. The Federal Competition Commission is fairly toothless, though a new law is supposed to give it more bite. Some analysts are hoping that

technological innovation will undermine Telmex's monopoly. But it is seeking to expand into new businesses, such as cable television.

By common consent, any increase in competition depends on the president's willingness to use the legal instruments available. Mr Ortiz has denounced the costs Telmex imposes on Mexico. Mr Gil says he pressed Mr Fox in vain to open the telecoms market. Mr Calderón can afford to be bolder. “The political monopoly of the PRI has ended but all other monopolies remain. There's a public demand to change that, because it carries a high cost for consumers,” notes Mr Aguilar Camín.

But private monopolies pale in comparison with the state monopoly of energy. Pemex's stranglehold on the oil industry, from exploratory drilling to refining to deliveries to petrol stations, goes back to 1938, when President Lázaro Cárdenas expropriated British and American oil companies, asserting that “*El petróleo es nuestro* (the oil is ours).” But rather than working for the Mexican people, Pemex works for the government treasury and for its own union. With almost 140,000 workers, it is wildly overmanned. Its pre-tax earnings last year were around $50 billion, but it invested only $13 billion. As a result, oil production is already falling and will decline rapidly unless new discoveries are made. Pemex is replacing only a fifth of the reserves it is depleting, and Mexico already imports 30% of the petrol and 23% of the natural gas it consumes.

Mr Zedillo's government made a first attempt at loosening Pemex's monopoly by allowing others to import natural gas, which required a change in the constitution. But in practice Pemex is still the sole importer. Mr Téllez, who as energy minister introduced that reform, says that the need for change is much more widely accepted now. He recommends gradual reform, starting with private investment in refining. Next, he would require Pemex to operate along more commercial lines, and then allow private investment in exploration. But the first thing that is needed is to give Pemex greater financial autonomy.

The electricity industry is dominated by two state-owned monopoly distributors, the Comisión Federal de Electricidad and, in Mexico City, Luz y Fuerza. Mr Zedillo changed the constitution to allow private investment in generation; Mr Fox has secured further investment through public-private partnerships. But electricity is expensive, despite subsidies equivalent to around 1% of GDP (which benefit the rich more than the poor). Luz y Fuerza is in thrall to its powerful trade union.

The PAN used to be suspicious of the PRI-dominated trade unions. But Mr Fox's government has appeased the most powerful unions, such as the teachers, the employees of the Social Security Institute, the Pemex workers and the electricians. Some economists argue for constitutional amendments to reform the unions and the labour market. In practice labour in many industries is quite flexible already. A better way of taking on the over-mighty unions would be to tackle the monopoly power that sustains a number of them.

In view of all these economic rigidities, and of the poor quality of the judicial system, it is little wonder that Mexico does not do well in league tables of international competitiveness. Mexican workers are only a third as productive as those in the United States. Foreign direct investment, apart from a couple of big bank takeovers, has fallen from 3.5% of GDP in 1994 to less than 2% a decade later.

Mexico does have a handful of big world-class firms. Cemex has grown to become the world's third-biggest cement company, with factories in 50 countries, thanks to professional management, a highly efficient production system and a string of acquisitions. Mexican beer has become a big export industry: Corona and Sol are two of the country's few international brands. Grupo Maseca, a tortilla maker, has opened a factory in China and is planning others. But most Mexican firms seem to lack ambition. Between January 2004 and June 2006 there were just 19 share offerings in Mexico, with a total value of $5.7 billion. Mr Fraser of UBS points out that the equivalent figures for Brazil are more than three times higher.

North of Mexico City there are outposts of innovation. On a patch of shrubland next to Monterrey's airport, the Tecnológico, with government partners, is building a technology park. Since 2003 it has set up 30 campuses across Mexico that are offering degrees in engineering and computing, linked to small business incubators. Mr Rangel, the Tecnológico's rector, points out that Mexico trains more engineers each year than the United States, China or India. He sees great potential for Mexico in industries such as aerospace, white goods, food, biotechnology and pharmaceuticals.

That may be tomorrow. But today the vast majority of Mexican companies are small businesses, many of them operating in the informal economy.

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The joy of informality

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Working in the official economy has its drawbacks

IN THE afternoon, try walking past the stately headquarters of the Bank of Mexico, across the Alameda from the massive new foreign ministry tower in the heart of Mexico City. Your progress along the pavement is slowed by a thick mesh of street vendors. Throughout the centre of Mexico City they hawk Chinese clothes and electronics, or pirated DVDs produced closer to home. They are just the most visible segment of a huge informal economy of unregistered businesses.

AP

No Stalinist monopolies here

According to a recent estimate by the World Bank, this sector accounts for slightly more than half of total employment in Mexico. That is about par for the course in Latin America. Contrary to some claims, informal work has not expanded in the dozen years since NAFTA came into effect, but nor has it shrunk, says Bill Maloney at the World Bank, who is preparing a book on the subject. And perhaps there is no reason why it should have done: NAFTA is just a trade agreement, albeit a sophisticated one. Unlike the European Union, it does not require the wholesale import of regulatory regimes and legal institutions.

The size of the informal sector goes a long way to explaining why Mexican productivity is so low: small businesses in this sector find it hard to expand or to innovate. It is also one of the reasons why the tax take is so meagre. But there is no simple recipe for change. Mr Maloney finds that many people consciously choose to work in the informal sector, not least because it is hard for those who never completed their basic education to get a well-paying job in the formal sector.

Tangles of red tape have made it unnecessarily hard for informal businesses to go legal. That is starting to change. A reform last year cut the average time it takes to set up a new business in Mexico City from 58 to 27 days. Together with cuts in federal corporate income tax and a new capital-markets law that improved corporate-governance standards, this lifted Mexico 19 places to 43rd (out of 175 countries) in the World Bank's latest annual survey on the ease of doing business around the world.

Even so, recent innovations in social policy may be making it more attractive to remain in the informal economy. Formal private-sector workers are obliged to contribute to the Mexican Institute of Social Security (IMSS), which provides pensions and health care, as well as to a housing fund. Between them, workers' and employers' contributions add up to a hefty 35% of wages.

The institute is yet another of Mexico's union-driven Stalinist monopolies. It administers the state pension scheme and is perhaps the largest single provider of health care in North America. Its trade union is the second-biggest after the teachers', with 380,000 members. Mr Zedillo reformed pensions,

switching from a pay-as-you-go system to Chilean-style individual capitalised accounts for new workers, but with one embellishment. The government makes a contribution to each account (at a total cost of $1.5 billion a year) because otherwise many pensions would be too low to live on. The Afores, as the new pension funds are called, now manage $61 billion in assets and have provided a natural market for the government's long-term peso bonds.

But the reform did not apply to the Social Security Institute's own employees (nor to other public-sector workers who have a separate social-security institute). So of each peso of contributions, 17 centavos go to the institute's own pensioners. In ten years' time this figure will rise to 30 centavos, says Mr Levy, who was Mr Fox's first IMSS director. He piloted a bill through Congress that would have switched new employees at the institute to a pension scheme similar to the one used in the private sector. But the union went on strike in protest, and Mr Fox caved in. So the health system for formal-sector workers continues to be short-changed. Moreover, thanks to the union, there are too many cleaners and clerks and not enough doctors and nurses.

Meanwhile, Mr Fox's government, with the best of intentions, has launched or expanded a range of non-contributory social-protection schemes for workers outside the IMSS. The IMSS covers only 13m workers, or 30% of the workforce. The schemes include Oportunidades, the anti-poverty programme that replaced a series of less effective transfers and subsidies. This year the government added a pension scheme to Oportunidades under which it contributes slightly more generously than it does to formal-sector pensions. Mr Székely, a former official at the social-development ministry, says that more than 95% of those who get Oportunidades have never worked in the formal sector. Mr Levy fears that if more benefits are added to the scheme, they never will.

Mr Fox's government also launched a health-care programme called Seguro Popular for those outside the social-security system. In practice, this is non-contributory. All told this year public spending on health for workers in the informal sector will total 131 billion pesos ($12.1 billion), against 107 billion pesos for those in the IMSS. Since 1998 public spending on social protection for informal workers has expanded by 110%; the figure for the social-security system is only 21%. Meanwhile, general public investment in infrastructure and the like has risen by just 0.8%.

Better at the bottom

Thanks to Oportunidades and the expansion of social protection, the poor are getting much more out of social spending than they did in the past. But rather than a minimum safety net, social protection is becoming a powerful competitor to the official social-security system—and one that will increasingly provide better health care for informal than for formal workers. It thus amounts to a tax on formality. As Mr Levy puts it, “we tax unskilled labour through the social-security system. Workers prefer to wash cars if they get free benefits.” Mr Calderón has promised that the government will pay the first year of contributions for every new job registered with the IMSS. But that will not solve the problem: many low-income workers registered with the IMSS drift into the informal sector later on.

The solution is not to dismantle social protection but to merge it with a reformed social-security system. A first step would be to separate the pension and health-care functions of the IMSS. A second step would create a universal non-contributory basic pension, supplemented by a freely negotiated contributory scheme. This would recognise that in Mexico, unlike in Brazil, the elderly tend to be poorer than the population as a whole, notes Mr Scott of CIDE. A third step would be to create a universal health-care system financed out of taxes (and/or by means-tested social insurance). This would replace the present rival systems, one contributory and the other in effect paid for from oil revenues. A fourth step would reform the labour market, reducing payroll taxes and severance pay. That would still offer to those who work in the informal sector more rights if they were to go legal.

Given that state governments are increasingly involved in the delivery of social policy, all this would involve complex negotiations. But the prize would be worth having: to provide incentives for formalising work, thus boosting tax revenues; and perhaps even to increase productivity and economic growth. “Social policy is economic policy,” concludes Mr Levy.

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Policing the police

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The rule of law is an aspiration, not a reality

THE informal economy is one of the more benign manifestations of lawlessness in Mexico. In recent years there have been many more frightening signs that the state, its police and its courts are unable to keep the peace and protect ordinary citizens. The biggest challenge has come from drug gangs. Brutal murders, often of policemen, are reported almost every day. Drug-related killings last year were running at twice the rate in 2004, and numbers have been rising further this year, to 1,500 in the first eight months. In recent weeks severed heads have been dumped on the dance floor of a night club in Michoacán and outside a police headquarters in the Pacific resort of Acapulco.

Drug violence is particularly serious along the northern border. The city of Nuevo Laredo, the busiest border-crossing point for goods to and from the United States, is still without a police chief after two were murdered last year. In September armed men briefly kidnapped 25 people in a hotel where they were waiting for an American visa to work for a company in Texas. That prompted a broadside from Tony Garza, the American ambassador to Mexico: “Violence in the US-Mexico border region continues to threaten our very way of life.” In the past two years, he added, there had been dozens of unresolved kidnappings involving American citizens along the border.

AFP

Underpaid, undertrained and often brutal

What Mr Garza did not say is that the violence in Mexico is in large part a result of the continuing failure of drug policy in the United States. Over the past decade the locus of power in the drug trade, as in so many other businesses, has moved closer to the final consumer. That means it has shifted from Colombia to Mexico, which is now the gateway for up to 90% of cocaine entering the United States, as well as ever-increasing amounts of marijuana and methamphetamine.

Mr Fox says that the upsurge in violence reflects his success in cracking down on the trade. Certainly his government has proved more effective than any of its predecessors. It has caught several of the top gang leaders, extradited about 50 suspected traffickers to the United States and seized record quantities of drugs. Much of this work is done by the army, but some also by the Federal Investigation Agency (AFI), a new police force modelled on the FBI. Where once there was total mistrust between law-enforcement authorities in the two countries, now there is active co-operation, at the top at least.

The problem, as Mr Fox implies, is that the government's actions have unleashed a turf war between two of the main gangs, one based on the Gulf coast and the other in Sinaloa. “It's like breaking a wasp's nest,” says Jorge Chabat, a political scientist at CIDE who has long followed the drug issue.

Drug violence is only one aspect of a wider problem of public insecurity. Rising crime over recent decades owes much to urbanisation and low economic growth, but in part it is also the legacy of authoritarian rule. After the revolution, policing was seen as a municipal matter. The job of the federal security services was to repress political dissent. Laws were to be applied with discretion, as a mechanism for doling out political reward and punishment. Corruption was the oil that lubricated the system. “In Mexico the law is an aspiration, not the norm,” says Bernardo León, a lawyer who advised Mr Fox on judicial reform. “We made many laws to look good, not to obey them. There is no public condemnation of lawbreakers.”

Which side are they on?

As crime has risen, so have public demands for security. Government responded by creating ad hoc police units. Today, Mexico has some 400,000 police in hundreds of different forces. On average policemen have spent just six years at school, have received only two weeks' training and are paid just $370 a month for the job, according to Mr León. Some 35% of them use drugs, and two-fifths leave each year. Many municipal and even state forces work for the drug trade rather than against it. Only the AFI is better-trained, better-paid and better-motivated, though there are signs that some of its officers may be falling from grace.

None of these police forces can investigate crime. That is the job of the Attorney General's office, known as the PGR from its Spanish initials, and its equivalents in the states. So dismal is its reputation that three-quarters of crimes are not even reported. Of those that are, under 10% lead to prosecutions. The courts are similarly dysfunctional. In 97% of cases suspects are found guilty, says Mr León. A confession is held to be unanswerable proof and so is often extracted by torture.

Mr Fox's government set up a new public-security ministry and channelled more money to local police forces. It also intended to turn the PGR into an independent prosecution service and to reform the judicial system, moving to adversarial oral trials in place of the current inquisitorial approach using written evidence. Some of this is starting to happen piecemeal at state level. But the government's plan to unify the police forces and create a single national code of criminal procedure was blocked in Congress.

Mr Calderón is likely to take up much of this unfinished agenda. He wants a judicial reform to “avoid the brutal impunity we have in Mexico”. The instinctive opposition of the states may make it hard to introduce a national police force. But in response to drug violence, a group of state governors has recently called for a complete rethink of policing, the judiciary and the prison system. “We don't reject anything but will have to look carefully,” says Natividad González Parás, the PRI governor of Nuevo León. “It's the start of a long discussion and transformation.”

What is missing from the discussion, says Marcelo Bergman, a sociologist also at CIDE, are proposals to make the police more accountable through performance measures and external evaluations. Making the PGR autonomous without first reforming it seems counterproductive. Better, says Mr Bergman, to end its monopoly of prosecution.

Two other changes are urgently needed. The first is to curb the *amparo*, a kind of injunction under which judges routinely set aside the law. This was used, for example, by Mr López Obrador when he was mayor of Mexico City to allow thousands of pirate taxis to operate freely there, in return for which their drivers turn out for him in his frequent demonstrations. The second is to set up a national police unit with skills in public order and crowd control, capable of ensuring that protests remain within the law without shedding blood.

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So close and yet so far

Nov 16th 2006
From The Economist print edition

Making the most of NAFTA requires change at home

THE two cowboy-booted ranchers, one from Guanajuato and the other from Texas, were quick to call each other *amigo* when Mr Fox visited George Bush at the White House in 2001. The American president declared that “the United States has no more important relationship in the world” than the one with Mexico. Mr Fox and Jorge Castañeda, his foreign minister, wanted a bilateral treaty on migration, and Mr Bush seemed receptive to the idea.

Yet as Mr Fox reaches the end of his term, Mexico's relations with the United States are clouded in disappointment. The terrorist attacks of September 11th 2001 and their aftermath changed Mr Bush's priorities. Mexico used a rotating seat at the United Nations Security Council to express its opposition to war in Iraq. And Mr Fox's hopes for a migration agreement were swamped by a rising tide of anti-immigrant feeling in the United States.

Getty Images

The ones who did not make it

Mr Bush proposed to combine tighter border security with easier legal migration and steps to legitimise the 11m migrants (6.3m of them Mexican) thought to be in the United States illegally. But only the first part is being implemented. In the run-up to this year's mid-term elections, Congress voted to add another 700 miles (1,100km) to the fences that currently stretch for 75 miles along the border. Earlier this year Mr Bush sent 6,000 National Guard to police the area. None of this will stop the flow of migrants, but it might reduce it by raising the risks and the price of crossing. Since May this has doubled to $5,000, according to Rafael Fernández de Castro of ITAM, a university in Mexico City. The United States Government Accountability Office reported recently that the number of deaths at the border rose from 254 in 1998 to 472 in 2005.

That angers many Mexicans. But they also know that there are limits to the border crackdown. If wages start to rise in the United States, American businessmen are likely to press for more legal migration. “The reality is that we have an integrated labour market and we ought to find ways to manage it,” says Jeffrey Davidow, the American ambassador in Mexico City from 1998 to 2002.

Because migration has become such a divisive issue, it is easy to overlook that relations between Mexico and the United States are “very constructive on dozens of issues in hundreds of ways every week”, as Mr Davidow puts it. Economic integration is binding the two countries more closely together every day. In Ciudad Juárez, across the border from El Paso, industrial parks, shopping malls and brand-new housing estates in faux-colonial style stretch out endlessly into the Chihuahua desert. Monterrey, the industrial hub of north-east Mexico, has become a handsome North American city of swirling freeways and glass office blocks, just the place to hold international conferences.

Mexicans were encouraged to believe that NAFTA would deliver instant prosperity. It has not done that, but it has certainly boosted Mexico's exports and made it more attractive to foreign investors. “It's been a huge success on both counts. You can't ask much more,” says Jaime Serra Puche, who negotiated the treaty as Mr Salinas's trade minister.

But the treaty has also thrown up some tricky issues. In January the tariff on imported American maize will be cut from 27% to 16%, and a year later to zero. The United States subsidises its maize farmers lavishly. South of the border, growing maize inefficiently in tiny *milpas* is not just a way of life for several million poor Mexicans, as it has been since long before the Spanish conquest; it is part of Mexico's national identity. So the issue is politically explosive. It prompted Mr López Obrador to say that he would

renegotiate the relevant chapter of NAFTA.

Opinion is split on whether the problem is more than symbolic. Mexico's imports of maize have risen since 1993, but so has production. The United States produces mainly yellow corn; the Mexican sort is white. Mr Serra points out that Mexico has had 15 years to help its farmers adapt, and has done nothing. Mexico should be the market garden of North America, producing fruit and vegetables, which are labour-intensive and can be grown on small plots. In the end demand for ethanol may push up maize prices.

Some Mexicans argue that their country needs European-style regional aid to adapt to NAFTA and halt the flow of emigrants. But it is hard to see why the American taxpayer should pay up when his Mexican counterpart contributes so little. The politicians are trying to deepen NAFTA in more humdrum ways, such as setting common standards and rules.

Despite increasing security concerns, traffic has continued to flow more or less smoothly across Mexico's northern border. Mr Fox's government has co-operated closely with the United States on security, sharing counter-terrorist intelligence, says Armand Peschard-Sverdrup at the Centre for Strategic and International Studies, a think-tank in Washington, DC. But there is scope for more.

Some Mexicans are also starting to think that tighter border security is in their own interests. Of the 1m people who cross the northern border each year without a visa, only half are Mexicans; the rest are mainly from Central and South America. If the northern border is porous, the southern frontier with Guatemala is “a huge sieve”, says Arturo Sarukhan, who advises Mr Calderón on foreign policy.

Under Mr Fox Mexico's foreign policy became less defensive than it had been under the PRI. That led to quarrels with Cuba and Venezuela. “The international agenda of Mexico is to support human rights. If you apply that to Cuba, it gets called interference,” says Luiz Ernesto Derbez, the foreign minister. Mr Calderón's foreign policy will pay more attention to Mexico's relations with Latin America, particularly Central America, says Mr Sarukhan.

Further afield, Mexico has signed free-trade agreements with the European Union and Japan, and has become an associate member of Mercosur. But trade with the EU has been disappointing. Mexican products increasingly tend to be North American products, which makes them ineligible under the rules of origin in the EU agreement. Geography dictates that Mexico's most important relationship will always be with the United States.

Look back a dozen years, and Mexico has indeed achieved much. Amid all the post-election turbulence, it is easy to forget that away from the centre of Mexico City and (for different reasons) Oaxaca, the country quietly got on with its business. The peso and the stockmarket sailed through the election with barely a blink. This economic stability provides a robust basis for faster growth.

Moreover, Mexico is a much more democratic, pluralist and open society than it was under Mr Salinas and his predecessors. This transition has been achieved without serious violence. Most Mexicans shunned Mr López Obrador's call to revolution. The electoral machinery has passed a severe test.

To go north, first head south

But it would be unwise to conclude that all is well. The clearest sign that it is not are those 500,000 young Mexicans who each year turn their backs on their country in search of better opportunities. Demography will eventually reduce that flow, but time is not on Mexico's side.

NAFTA no longer gives Mexico a unique competitive advantage. Central America now has a free-trade agreement with the United States, and Peru and Colombia may soon follow suit. China and India are sucking in a lot of the foreign investment that Mexico had hoped for. Manufacturing wages in Mexico are only one-tenth those in the United States, but more than three times those in China. If it wants to keep ahead of China, and stop its own people from leaving for better jobs north of the border, Mexico must move to higher-value manufacturing.

Yet the country often seems less ambitious than its own migrants. A long history of authoritarian rule has discouraged risk-taking. People are used to being told what to do, and in return they expect the state to provide for them. This is especially true in Mexico City and the south. Mr Téllez says that in his job as head of the Mexico office of Carlyle, an American private-equity group, he visits Monterrey once a month

to see firms who need capital, but has never had cause to travel south of Mexico City. The difference, he says, is that the north has specialised in business rather than government. In the south suspicion of private, and especially foreign, investment remains widespread. Throw in a history of mistrust of the United States, and Mexican ambivalence towards globalisation is understandable. If the PRI had a lasting ideology, it was nationalism. Yet ordinary Mexicans are noticeably less anti-American than the political elite.

But the main thing holding Mexico back is that partial reform has produced partial results. “As long as our income distribution is as bad as it is, many people don't see the benefits of globalisation,” says Mr Derbez. The country is split more or less evenly between those who have benefited from the changes of the past two decades and those who have not.

Economic stability, NAFTA and democracy are three great achievements. But they should be the starting point for more effective public policies, not an excuse to go back to sleep. It is time for the government to sweep away the remnants of crony capitalism, set the economy free and liberate the south from its backwardness. Mr Calderón does seem determined to turn Mexico into a prosperous and global capitalist democracy. Wish him luck.

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Sony

Playing a long game

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From The Economist print edition

AP

Can the PlayStation 3 revive the ailing electronics giant?

THINGS have not been going well for Sony lately. Last month senior executives at the Japanese electronics giant issued an unprecedented apology after discovering that 9.6m laptop batteries, supplied to other computer-makers, were faulty and would have to be recalled at a cost of $436m. Sony's Blu-ray high-definition technology, launched this summer, has suffered from delays and component shortages, and is embroiled in a standards war with the rival HD-DVD format. American regulators began investigating the company last month as part of an inquiry into allegations of price-fixing in the memory-chip market. And having long been the world's most valuable electronics firm by stockmarket value, Sony's market capitalisation has fallen to less than half that of Samsung, its South Korean rival. “They really need some good news,” says Paul Jackson of Forrester, a consultancy.

So a lot is riding on the PlayStation 3 (PS3), the latest incarnation of Sony's industry-leading games console, which was launched with much fanfare in Japan on November 11th. In Akihabara, Tokyo's neon-lit electronics district, stores drafted in extra workers to cope with easily the biggest product launch of the year. At the Yurakucho flagship store of Bic Camera, one of Japan's largest electronics retailers, hundreds of gamers queued through a cold, damp night. Ken Kutaragi, who runs Sony's gaming division, was there to welcome them in the morning.

At Yodobashi Camera in the southern city of Fukuoka, half of the 400 people queuing were Chinese immigrants with orders to snap up the store's assignment for resale online in China. Across Japan, the PS3 had sold out by lunchtime. Similar scenes were expected at its American launch on November 17th. On Tuesday there were already over 100 people camping outside Sony's New York store.

Not so fast

Sony needs the PS3 to succeed for three reasons: to maintain its lucrative dominance of the games industry; to seed the market for Blu-ray and establish Sony in the emerging market for internet video downloads; and to demonstrate that the turnaround being led by Howard Stringer, who took over as chief executive in 2005, is working and that Sony's gaming, electronics and content divisions really can work together. Despite the enthusiasm of the PS3's early buyers, success in each of these areas is far from assured.

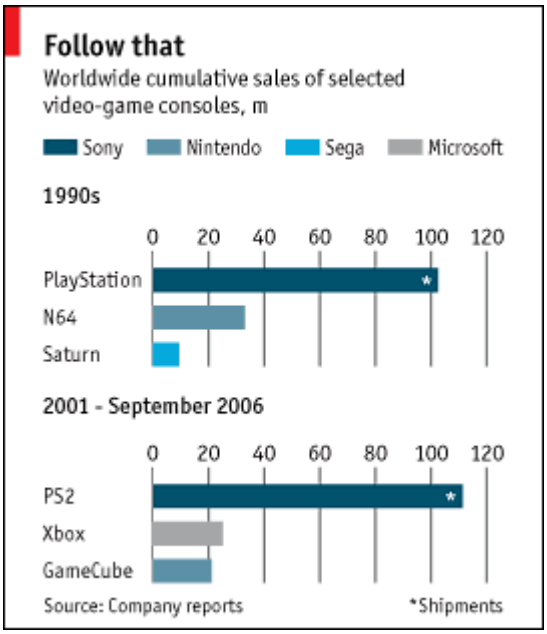
In gaming, Sony faces far stronger competition than it did when it launched the PlayStation 2 in 2000.

The PS2 went on to sell over 100m units, giving Sony 70% of the market. But gaming is a cyclical business, and success in one round does not guarantee success in the next. Microsoft has already sold over 6m of its Xbox 360 consoles, launched a year ago, and expects to have sold 10m by the end of 2006. Nintendo, Sony's other rival, will launch its new console, the Wii, on November 19th, and expects to sell 4m units by the end of the year. Manufacturing problems delayed the PS3's launch from May and meant that only 93,000 consoles were available for the Japanese launch. Sony hopes to sell 2m by the end of the year, but even if it does so, it will start the race in third place.

Availability is one weakness; pricing is another. The PS3 is available in two configurations, costing $500 and $600 in America, and ¥50,000 ($425) and ¥60,000 ($510) in Japan. That is far more than rival consoles (the Xbox 360 starts at $300 and the Wii costs $250) and is due to the inclusion of a Blu-ray optical drive in every PS3.

Sony will lose money on each PS3 sold for the first couple of years until higher volumes and design improvements reduce costs. But it will make money by taking a cut of every game sold. Worryingly, however, less than one game was sold per PS3 in Japan this week, which suggests that some buyers regard the PS3 as a subsidised Blu-ray player—which it is. Dedicated Blu-ray players start at around $750. The PS3, in short, will not be the moneyspinner that the PS2 was for quite some time, and it seems unlikely to achieve the market share of its predecessors (see chart).

The PS3 is also meant to ensure that Blu-ray triumphs over HD-DVD as the high-definition successor to the DVD video format. The idea is that millions of PS3s bought by gamers will seed the market for Blu-ray, providing it with critical mass and ensuring that Hollywood studios, which are reluctant to back two rival standards, plump for Blu-ray over HD-DVD. But instead of riding the PS3 as a Trojan horse, Blu-ray has instead hobbled it by increasing its price and delaying its introduction. The battle between Blu-ray and HD-DVD may even prove irrelevant, as internet downloads become the medium of choice for high-definition video. Both Sony and Microsoft plan to sell high-definition video downloads via their consoles.



Finally, the PS3 is a litmus test for Sir Howard's turnaround effort, one of the aims of which is to get Sony's various divisions to co-operate more fully. (A spat between its electronics and content units left the field open for Apple's iPod.) The company insists that despite recent problems such as the battery recall, the turnaround is going well behind the scenes. Sony has improved margins in its electronics business and reduced headcount by 10,000 ahead of schedule. It is also on track with factory closures, asset disposals and winnowing its product line-up to focus on “champions” such as Cyber-shot digital cameras, Bravia televisions and, of course, the PS3. Sir Howard even suggested this week that the battery fiasco had helped by making it easier for him to convince doubters within Sony of the need to change.

Yet it will be some time before it is possible to tell whether the PS3 can rescue Sony. Beneath the short-term troubles, the company is playing a long game. “This is not a battle that's just about this Christmas,” says Rob Wiesenthal, the finance chief of Sony's American division. Sony is betting that the PS3's advanced technology will sustain the company for a decade by extending the PlayStation franchise beyond gaming. So a few teething problems in the early days are nothing to worry about; besides, the PS2 was also criticised for being expensive, over-engineered and unreliable when it first appeared. But having achieved 70% market share last time around, Sony is certain to lose ground this time. The only question is how much.

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Deutsche Telekom

Send in the Bulldozer

Nov 16th 2006 | FRANKFURT
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The problems at Germany's former state-owned leviathans run deep

TWICE in one week bosses at giant German corporations have been ousted by their shareholders, with help from workers' representatives on the supervisory board. Kai-Uwe Ricke, head of Deutsche Telekom, was forced out on November 12th, four days after presenting results that failed to lift the share price. On November 7th Bernd Pischetsrieder, head of Volkswagen (VW), suffered a similar fate at the hands of Ferdinand Piëch, a big VW shareholder, backed by workforce allies on the supervisory board, which he heads.

Installing a new boss will not, however, magic away the problems at either firm. Both companies have a legacy of state ownership and powerful worker representation. René Obermann, the new boss at Deutsche Telekom and a friend of Mr Ricke, is unlikely to change its strategy that much, though his more entrepreneurial style—he is fondly known as “the Bulldozer”—could lift the company's spirits and share price for a while.

The problems facing Mr Obermann include the loss of 1.5m fixed-line German customers in the first nine months of the year; growing competition from cable and mobile operators; a workforce which is at least 30,000 too big coupled with an agreement not to cut jobs except by natural attrition until the end of 2008; and a legacy of 77,000 employees with civil-servant status, which means they cannot be fired.

Mr Obermann brings with him a record of success at T-Mobile, the group's top-earning division. But he has at least three big shareholders snapping at his heels. The government still owns 32%, and in April it sold 4.5% to Blackstone, a private-equity firm, signalling that it wanted Telekom to be more market-driven, though eight months later it balked at selling a further stake to Sistema, a Russian firm. Blackstone got a seat on the supervisory board but saw its €2.68 billion ($3.4 billion) stake lose €400m in paper value between April and October. Since Mr Ricke's departure the share price has climbed back close to Blackstone's purchase price of €14.

The third active shareholder is Laxey Partners, a British hedge fund. It wrote last month to Klaus Zumwinkel, the head of Telekom's supervisory board, and called for the firm to refocus on Germany, possibly by selling T-Mobile's American arm to finance investments in Europe. Several analysts have argued that Telekom's parts are worth more than its present market value.

All of this provides a cautionary tale for Deutsche Bahn, the state-owned railway, which won government approval last week to prepare for privatisation in 2009. Does Hartmut Mehdorn, the head of Deutsche Bahn whose contract ends in 2008, really want to saddle his successor with the kind of problems faced by Mr Obermann at Deutsche Telekom: shareholder pressure on one side and powerful unions, plus a legacy of state ownership on the other? Deutsche Bahn has around 45,000 unsackable civil servants on its payroll.

German law requires half of the supervisory board members at big firms to be workers' representatives. That gives the unions sizeable power as kingmakers. There are some hopeful signs: a new law, passed in October, provides for early retirement at 55 by mutual consent for some former civil servants, though the company, not the taxpayer, must pick up the tab. And Deutsche Post, with 60,000 unsackable civil servants on its payroll, has prospered by turning into a global logistics firm. But without further changes to the labour laws, the bosses of these former state-owned leviathans are fighting with one hand tied behind their backs.

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Beretta

Switching targets

Nov 16th 2006 | GARDONE VAL TROMPIA
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James Bond has reinvented himself—and so has Beretta, his former gunmaker

MOST firms use metal detectors to keep lethal hardware out of their offices by scanning visitors as they enter. But not Beretta, an Italian firearms-maker. At its premises at Gardone Val Trompia, near Brescia in northern Italy, visitors are scanned as they leave, to ensure they have not walked off with one of its famous products.

Beretta is known for its handguns, thanks in part to Ian Fleming, who equipped James Bond with one of its pistols in his early books, and in part to the adoption of the Beretta 92 pistol by America's armed forces and many law-enforcement agencies. But handguns now account for less than one-third of total sales, says Pietro Gussalli Beretta, the firm's executive vice-chairman and a member of the family that has made firearms for 15 generations, starting in 1526. Beretta has reinvented itself in the past decade, a change as dramatic as the reinvention of its most famous customer in “Casino Royale”, the latest Bond film.

The transformation began with the purchase in 1995 of Franchi, another gunmaker in Gardone Val Trompia that had run into difficulties. Beretta also took full control of Benelli, an upmarket shotgun-maker based in Urbino, in central Italy. A series of other acquisitions in Finland, Turkey and China expanded its range of rifles and shotguns. Meanwhile Beretta diversified, buying Burris, a maker of sports binoculars and precision scopes based in Colorado, as it started to reshape itself from a gunmaker into a luxury outdoor brand. It began selling its own clothing and accessories in the 1990s, and these accounted for €25m ($31m) of the group's €400m sales last year. Beretta opened a store on Madison Avenue in New York in 1995 and another on London's St James's Street last year. Next on the list are Florida, Chicago and Moscow.

In several respects Beretta is a typical medium-sized Italian firm. It operates in a traditional industry, is located in the north, is reliant on export markets and is owned by a family that is not interested in a stockmarket listing. But in other respects it is unusual. It owns strong international brands, employs almost half of its workforce outside Italy, spends heavily on innovation and has recruited top managers from outside the family. Odder still, Mr Beretta and his immediate family own 98% of the firm's shares. (At most family firms, ownership is highly fragmented.) “An accident of nature and mortality,” explains Mr Beretta, “but it does help decision-making.”

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Airlines in America

The elephants learn to dance

Nov 16th 2006
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US Airways' bid for Delta is just one sign of airlines' recovery in America

AP

Coming to get you

IN THE clearest indication yet that things are improving in America's creaking airline industry, US Airways launched an $8.7 billion hostile takeover of Delta on November 15th. A friendly approach was rejected last summer, so US Airways' boss, Doug Parker, has decided to appeal to the bankrupt airline's creditors. The advantage of making a move now is that it is easier to cut jobs and slash costs while an airline is in Chapter 11 bankruptcy, as Delta has been since last year. Mr Parker says annual operating savings from the merger could amount to $1.65 billion, but would be only half that if he waited until Delta emerged from bankruptcy.

If the deal goes ahead, it would create America's largest airline. And even if it does not, there are other signs that life is returning to the sector. Two low-cost carriers, Frontier and AirTran, are pooling their marketing and mileage programmes to boost their prospects. This shows how budget airlines are coming under pressure as the network carriers recover their strength. Delta, which has just launched a big sale of discounted seats, feels it has cut costs enough to be able to offer low fares to win back business, taking the initiative in the price war that often happens in the run-up to Thanksgiving, the peak weekend for domestic air travel.

Having lost a staggering $35 billion in the past five years, America's airlines are now climbing out of the pit they fell into in 2001. The industry's operating losses last year fell to just $130m, compared with $2.3 billion in 2004. This year it will end up in profit, and next year it expects significant operating profits as demand picks up and cost savings take effect, though restructuring costs will keep net results in the red.

At one point four of America's six big airlines were in Chapter 11. US Airways emerged last year, thanks to a merger with America West, and United Airlines escaped in February after three years. Today only Delta and Northwest are still in Chapter 11. In the past five years the airlines have shed a quarter of their capacity and nearly 40% of their workers, some 169,000 in all. As a result of these jobs cuts and concessions won from unions, labour productivity has risen by one-third.

American Airlines and Continental, the pair that dodged the bankruptcy bullet, are showing the way back to profitability. In the third quarter American reported a net profit of $114m (excluding charges related to hedging its fuel bill), compared with a loss of $95m in the same quarter last year. Continental's net profit more than doubled to $146m, as revenues increased by 17.2%. The other star performer among the big airlines has been US Airways, which reported an operating margin of 4.4% over the first nine months of this year, giving it the confidence to go for Delta.

Such profitability pales beside the leader of the low-cost carriers, Southwest Airlines. It raked in an operating profit of $820m last year, despite soaring fuel prices. But other low-cost carriers have not been doing so well. JetBlue has had a grim 18 months. Last year its operating margin fell from 8.8% to 2.8%, and it made a loss of $0.5m in the third quarter. It is now cutting costs by selling off some of its jets. Similar bad news emerged from AirTran. In its third quarter it reported an operating loss of $3.6m, compared with a profit of $3.4m a year earlier. But now it is fighting back by teaming up with Frontier.

All this illustrates how the business models of big carriers and budget airlines are converging. JetBlue, for instance, is known for offering value for money, rather than just rock-bottom fares and service. And their

productivity improvements show that the big carriers, for their part, are learning some low-cost tricks.

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Blogging

Going pro

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More people are quitting their day jobs to blog for a living

ON HER blog, called Dooce, Heather Armstrong chronicles her life as a disenchanted Mormon in Salt Lake City, her former career as a high-flying web designer in Los Angeles, her pregnancy and postpartum depression, and so on. A year ago, her blog started generating enough advertising revenue to become the main source of income for her family. She is not alone. There are now just enough people like Ms Armstrong to signify a new trend: blogging as a small business.

Until recently, there were two main kinds of blogs. Most of the 57m blogs in existence are personal diaries that happen to be online. These blogs have tiny audiences and make no effort to sell advertising. Services such as Google's AdSense, which places text advertisements on blogs and generates a few cents per mouse click, might bring in some spare change. But according to Pew, an American research organisation, only 7% of bloggers say their main motivation is to make money.

The second main kind of blogs are, in effect, niche magazines that choose to publish in a blog format. These blogs are explicitly run as businesses, with paid staff doing the writing and sales departments selling advertising. The best example is Gawker Media, a stable of blogs that includes Gawker, a New York gossip site, and Gizmodo, a blog devoted to gadgets. Collectively its 14 blogs get 60m page views a month. Such blogs are “the most profitable media business today,” says Jason Calacanis, who runs Weblogs Inc, another stable of popular blogs that he sold to AOL, the web arm of Time Warner, a year ago. His sites, including Engadget, another gadget blog, are “an eight-figure-a-year business” with negligible distribution costs compared with the huge printing and shipping bills of traditional magazines.

Now, however, a third category is emerging: the mom-and-pop blog. “In the old days, we used to be called newsletter publishers,” says Om Malik, a technology writer who quit his job at *Business 2.0* magazine in June to work full-time on his blog, GigaOm. He has hired two other writers, and his blog now attracts about 50,000 readers a day, generating “tens of thousands” in monthly revenues. Costs, including salaries, are around $20,000 a month.

One big reason why his blog works as a small business, says Mr Malik, is that an ecosystem of support is appearing. Like Ms Armstrong, he farms out advertising sales and administration to a firm called FM, launched last year by John Battelle, who once ran magazines such as *Wired* and the *Industry Standard*. In his old business of magazines, says Mr Battelle, the cost of acquiring an audience was “stupendous”—at *Wired* it was about $100 per subscriber. The cost of building a readership for a blog, by contrast, is nil. Once you have a lot of readers, however, the bandwidth costs become significant, and most medium-sized blogs cannot afford to hire the sales people needed to generate sufficient revenue. So FM's 15 sales people negotiate with advertisers on behalf of blogs they represent, keeping 40% of the resulting revenues.

For people like Ms Armstrong, who has about 1m visitors to her site a month, this makes blogging worthwhile. But it is not for everybody, she notes. She works about seven hours a day on her site, and continues to work while on holiday. Mr Malik concurs. “It's not easy,” he says. Building his audience has “taken me five years, and a lot of sleepless nights.”

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Mining in South Africa

Undermined

Nov 16th 2006 | JOHANNESBURG
From The Economist print edition

Regulatory uncertainty has harmed South Africa's mining industry

Get article background

THE past five years have been a good time to be in the mining business. Commodity prices have boomed, boosted by healthy economic growth and China's appetite for minerals. According to PricewaterhouseCoopers, a consultancy, the world's big mining companies had a spectacular year in 2005, with investment increasing by about 30% and profits by almost 60%. Except, that is, in South Africa.

According to figures published last week by the South African Chamber of Mines, investment in the country's mining sector declined by almost a third in 2004 and 2005. South Africa's mineral operating profits grew by just 12% in 2005, and production fell by 6% in the first half of this year. Why does one of the world's top mining countries seem to be missing out on the commodities boom?

Currency movements are partly to blame. The value of the rand against the dollar (in which commodities are priced) more than doubled between December 2001 and December 2004, offsetting commodity-price increases. Congested railways and ports have also been a problem, especially for coal and iron ore. And gold, once the pillar of South Africa's mining wealth, has been in decline. Although South Africa remains the world's largest gold producer, costs have risen and production has dwindled. Platinum and coal now generate more money.

But another big problem, according to a survey carried out by the Chamber of Mines, is red tape and regulatory uncertainty, which have cost the sector 5-10 billion rand ($0.7 billion-1.4 billion) a year in lost investment. In 2004 mineral rights were transferred from private to state hands, and firms must convert their existing licences into new ones. To do so, they must establish labour and social programmes and detail plans to transfer 26% of their ownership into non-white hands by 2014, as part of South Africa's “black economic empowerment” initiative.

Some of the big gold and platinum producers, such as AngloGold Ashanti, Gold Fields, Harmony, Lonmin and Aquarius, have been granted new licences for existing mines. Many others are still waiting, however. The government says their labour, social and ownership-transfer plans are often inadequate. But Peter Leon of Webber Wentzel Bowens, a Johannesburg law firm, says the delays are a symptom of a bigger problem. He argues that the rules that regulate the industry are too vague and do not include measurable, objective targets for labour and social reforms. This creates uncertainty and gives discretionary power to the Department of Minerals and Energy, which determines whether proposals are adequate or not.

In some cases, mining firms are turning to the courts for answers. But until negotiations and court rulings resolve matters, much uncertainty remains. A further complication is that the government plans to require mining firms to pay royalties but has yet to finalise its proposals. A recent survey by the Fraser Institute, a Canadian research body, ranked countries by their governments' mining policies. South Africa came 37th out of 64, behind Ghana, Mali and Botswana. Chile, where mining licences are awarded by the courts based on clear criteria, ranked fourth.

Big companies are unfazed. Anglo Platinum, for example, has not yet received converted rights for existing mines, but is confident that it will, and says the delays have not affected operations or investment. But smaller mining firms contemplating risky investments may take a different view. About half of global exploration is now undertaken by smaller firms, most of them Australian and Canadian. According to Metals Economics Group, a research outfit in Canada, spending on exploration between

2003 and 2005 increased by 123% globally, but by only 60% in South Africa.

Things are looking up, however. The rand has weakened in the past 18 months, and rail and port facilities are being improved. The Department of Minerals and Energy has said it will issue new prospecting licences within six months of application, and mining ones within one year, and the pace has accelerated in recent months. Investment in the sector also seems to be picking up. So in spite of the troubles of the past two years, there could be light at the end of the tunnel.

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Face value

The view from 36,000 feet

Nov 16th 2006
From The Economist print edition

AP

Fred Smith, the boss of FedEx, has a unique perspective on the outlook for world trade and economic growth

THE tabloids have christened Kevin Federline, the soon-to-be-former spouse of pop star Britney Spears, Fed-Ex. This has resulted in the sort of headlines—such as “Fed-Ex threatens Britney with sex tapes”—which might upset some chief executives, but not Fred Smith of FedEx, a global shipping and logistics firm. “I heard about that from my daughter,” he laughs, apparently enjoying this latest illustration that the firm he started in 1971, based on a business plan that his professor notoriously graded as merely average, has achieved iconic status. For years, FedEx has been a member of that select group of companies whose names are used as verbs.

Today, people all over the world are FedExing like never before, giving Mr Smith a unique perspective on the outlook for world trade. The firm's share price is again nearing the record high from which it plunged in the summer as investors feared that the American economy, and perhaps the global economy with it, was in trouble. That would have meant many fewer packages for FedEx to fly around the world—it is the world's second-largest airline by size of fleet—and deliver with its thousands of trucks. From his lofty vantage point, Mr Smith concedes that there are pockets of weakness in America's economy, notably in the housing and car industries, which have caused some knock-on effects on exports from developing countries such as China. Yet he foresees less volatility in future, thanks in part to the positive impact that firms such as his have had on the efficiency of corporate supply chains. “Economic corrections are getting smaller,” he says, because better supply-chain management means firms can more easily adjust to small changes in demand. This “gets rid of the whiplash effect” that slowdowns had on the economy in the days of looser supply chains.

The model that Mr Smith cooked up at Yale, based on a hub-and-spoke system of overnight air delivery, has since expanded to encompass a broad portfolio of businesses contributing to efficient supply chains. FedEx now has a leading position in the ground parcel-delivery business, especially in America. Mr Smith was not the only average student who would later amount to something: George Bush, his contemporary at Yale, remains a friend and recently visited the firm to sing its praises. This prompted protests from the unions, which are treated better by FedEx's main rival, UPS, and have struggled in vain to gain a foothold in Mr Smith's firm. “The unions would love to Wal-Martise us,” he says, but they have failed to do so because (and Wal-Mart may not thank him for the implicit comparison) “our people make very good wages and receive very good benefits.”

Mr Smith, who at 62 shows no interest in retiring, remains exceedingly bullish about China, where FedEx

has been operating for 22 years. It is in the final stages of buying out the local Chinese joint-venture partner that was foisted on it by the government. This will give FedEx the “freedom to expand the business as the market demands.” It is about to move into a massive new base at Guangzhou's Baiyun airport. The Chinese government has been extremely clever in its design of its logistical infrastructure, putting all its new airports “in the right place”, says Mr Smith, who nonetheless seems queasy about the means to that end. “They moved whole villages,” he says, noting the impossibility of doing likewise in India: “There are 250,000 squatters living around Mumbai airport—you couldn't expand it under any circumstances.” The infrastructure challenges facing India are the main reason why Mr Smith, despite seeing growth opportunities there, thinks China has the greater promise.

The need to make the most of these opportunities lay behind his recent decision to cancel FedEx's order for ten air freighters based on the huge A380 super-jumbo after its maker, Airbus, put back the delivery date a second time. Originally, the aircraft were due in 2008, but this was delayed to 2009 and then 2010 and “we weren't 100% comfortable we would get them then,” says Mr Smith. He admits to surprise that Airbus did not cancel the order first, so it could focus on meeting orders for pricier passenger versions of the aircraft. FedEx will instead buy more long-range 777 aircraft from Airbus's rival, Boeing.

Which way will the trade winds blow?

With America's Democrats regaining control of Congress and anti-free-trade rhetoric on the increase, you might expect Mr Smith, a lifelong committed free-trader, to be downcast. Yet he seems remarkably untroubled. True, he thinks America should unilaterally lift barriers to farm trade, though he sees little sign of that happening. He reckons that, despite all the protectionist talk from politicians and from Lou Dobbs, a cable-news pundit, there is little popular support in America for rolling back the trade liberalisation that has already taken place.

He dismisses fears that, with the Doha round of trade-liberalisation talks on hold, the progress of the past quarter-century might be reversed, much as the protectionist Smoot-Hawley act was introduced during tough times in 1930. Farm-trade reform may now be stalled indefinitely, says Mr Smith, but “nobody is charging around saying that iPods for America will have to be built here in future, or that semiconductors can no longer be built in Taiwan, or no Brazilian aircraft for JetBlue.”

In large parts of the American and global economies, trade liberalisation has already taken place. If there was a real danger of the “political class passing an equivalent of Smoot-Hawley, the 25% of the population involved in the tradable sector would stop it,” asserts Mr Smith. Is he right? *The Economist* would like to think so, and not just because Mr Smith is so uninhibited in his criticism of Mr Dobbs and other protectionists. But the sobering lesson of Smoot-Hawley is that free traders can never afford to relax about the threat from protectionists—even when looking down on them from 36,000 feet.

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Investing in clean energy

Tilting at windmills

Nov 16th 2006 | LONDON AND SAN JOSE
From The Economist print edition

The clean-energy business is turning into the next big investment boom, in which risks are lightly brushed aside

AP

UNTIL recently, recalls Charlie Gay, a 30-year veteran of the solar-power business, venture capitalists were far too busy catering to captains of the information-technology industry to waste time on “hippy-dippy tree-huggers” like himself. But now the tree-huggers are in the ascendant and the IT barons are busy investing in clean-energy technology.

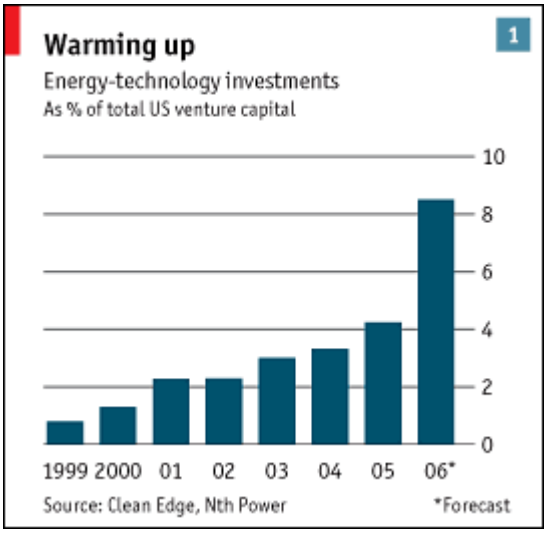
Among them is Vinod Khosla, a celebrated Silicon Valley financier. He is touting ethanol as the next big thing. Applied Materials, where Mr Gay works, has branched out from flat screens and computer chips into solar cells. Sun Power, the solar subsidiary of Cypress Semiconductor, is now worth almost as much as its chipmaking parent company.

Investors are falling over themselves to finance start-ups in clean technology, especially in energy. Venture Business Research reckons that investment in the field by venture capitalists and private-equity firms has quadrupled in the past two years, from some $500m in 2004 to almost $2 billion so far this year. The share of venture capital going into clean energy is rising rapidly (see chart 1). New Energy Finance, another research firm, reckons that investment of all sorts in the business will reach $63 billion this year, compared with just $30 billion in 2004. The lure of big money is leading investment banks to ramp up their analysis of the latest boom industry.

Clean-energy fever is being fuelled by three things: high oil prices, fears over energy security and a growing concern about global warming. The provision of energy, the industry's cheerleaders say, will change radically over the coming decades. Polluting coal- and gas-fired power stations will give way to cleaner alternatives such as solar and wind; fuels derived from plants and waste will supplant petrol and diesel; and small, local forms of electricity generation will replace mammoth power stations feeding far-flung grids. Eventually, it is hoped, fuel cells running on hydrogen will take the place of the ubiquitous internal combustion engine. It is a bold vision, but if it happens very slowly, or only to a limited extent, boosters argue that it will still prompt stupendous growth for firms in the business.

Analysts confidently predict the clean-energy business will grow by 20-30% a year for a decade. Jefferies, an investment bank that organised a recent conference on the industry in London, asked participants how soon solar power would become competitive with old-fashioned generation technologies: in 2010, 2015 or 2020. More distant dates—let alone never—were not even discussed. About three-quarters of those present, one visitor gleefully observed, were “cheque-writers”. This “megatrend”, the keynote speaker gushed, “may be the biggest job- and wealth-creation opportunity of the 21st century.”

At a similar event devoted to solar power at San Jose, in the heart of Silicon Valley, registrations almost quintupled this year, to over 6,500 attendees. Arnold Schwarzenegger, California's green-minded governor, made a cameo appearance in the midst of his re-election campaign. “I feel the energy,” he bellowed to an elated audience, “I feel the electricity. Clean energy is the future.”



Such hyperbole might seem reminiscent of the dotcom bubble. But clean-energy advocates insist growth is sustainable because of the likes of Mr Schwarzenegger. The Gubernator is a hero in green circles because of his enthusiasm for environmental regulation. He easily won re-election partly because he seized on global warming as a concern and signed into law America's first wide-ranging scheme to cap greenhouse-gas emissions.

California also boasts America's most ambitious initiative to promote solar power, dubbed “One Million Solar Roofs”. The state will pay $2.9 billion in rebates over ten years to households and businesses that install solar panels. The federal government also chips in with a tax credit of 30% of the cost of installation. All manner of businesses in the state, from FedEx to wineries in Napa Valley, are rushing to install subsidised solar panels (see article).

Renewable states

By 2010, California aims to generate 20% of its power from renewable sources. No fewer than 21 of America's 50 states have such “renewable portfolio standards”, which local utilities are obliged to meet within a set period. Voters in Washington approved one in the recent elections. Maine has the highest standard, of 30%, although its utilities already meet it thanks to the state's many hydroelectric dams. Among the most ambitious is New Jersey's, which will require 22.5% of energy to come from renewables by 2021. It has already become the second-biggest solar market in America, after California.

Other government policies ensure that making ethanol from corn is a lucrative business, despite lingering concerns that the manufacturing process consumes almost as much energy as the resulting fuel provides, so that the effort does no good for the environment or the cause of energy independence. Farmers receive subsidies for growing corn, refineries for mixing it into fuels, service stations for installing pumps to sell it and consumers for buying it. Moreover, several states have laws requiring that a certain amount of ethanol is mixed into petrol, helping to bolster demand. A recent study by the Global Subsidies Initiative, a pressure group, estimated that all this will cost American taxpayers at least $5 billion this year.

America's incentives for clean energy, however, are relatively modest compared with Europe's. The European Union, for example, wants 5.75% of all transport fuel to come from non-fossil sources by 2010. Big refiners say the measure guarantees them a market for as much biodiesel as they can produce.

The EU also has a target for power from renewable sources of 18% by 2010. Analysts at Goldman Sachs, an investment bank, calculate that solar output would have to grow by over 30% a year to meet it. By their count, 49 countries have policies on renewables in place that will foster rapid growth at clean-energy firms, including big emerging markets such as Brazil, China and India.

Germany is perhaps the most generous. It has fixed the price of renewable power for the next 20 years on a sliding scale that will decline over time. Certain solar projects will receive as much as €0.57 (73 cents) for each kilowatt-hour of electricity generated, compared with the going rate for dirtier power of around €0.05. In normal circumstances, Germany would be a terrible place to install solar panels: it is not very sunny and has a good distribution grid, which solar does not require. But thanks to its “feed-in tariff”, it is the biggest solar market in the world.

Around the world governments like Germany's have pledged billions, or in some cases unlimited sums, to advance the clean-energy cause. In the process, enthusiasts claim, they have “pre-booked” growth. Supporters argue that these subsidies are reasonable, since they encourage a worthwhile cause—the fight against global warming—that markets do not seem to prize highly enough.

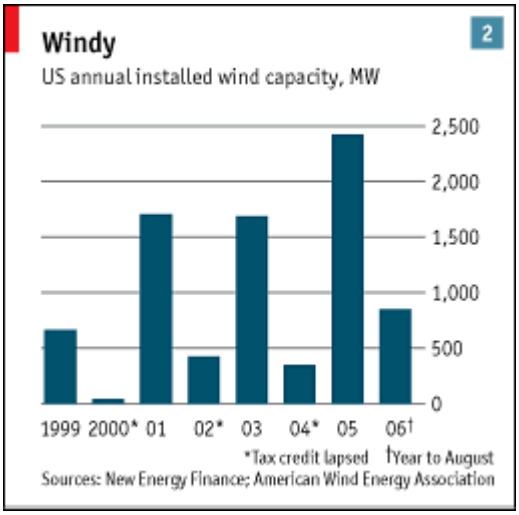
What is more, the subsidies are not supposed to be permanent. Applied Materials' Mr Gay points out the cost of generating solar power falls steadily over time. The first cells, in satellites, cost about $200 per watt of generating power. By last year the price had fallen to about $2.70 per watt. That equates to a price decrease of about 18% every time production doubles, he calculates. Price decreases come inexorably with volume, he argues, so subsidies simply help to speed the process up by stimulating extra sales.

When subsidies go

Eventually, the proponents of clean technology maintain, renewable energy will become competitive with fossil fuels, allowing governments to end subsidies. Mr Gay thinks solar power will be as cheap as that from big coal-fired power stations within a decade. Something of the sort has already taken place in Japan, where last year subsidies for solar were phased out. When these were introduced in 1994, says Chris O'Brien of Sharp, the world's biggest maker of solar cells, a system typically cost some $16,000 per kilowatt, of which the government paid half. About 500 systems were installed in the first year. A decade later, the cost had dropped to $6,000 per kilowatt and 60,000 systems were fitted. Nowadays, he says, Japan is the first market “where customers have continued to buy solar systems without subsidy”.

However, all this is somewhat misleading. Retail electricity prices in Japan are among the highest in the world, making it much easier for solar to compete. In most places, concedes Michael Liebreich, of New Energy Finance, renewable power and fuels will be more expensive than the dirtier sort for the “foreseeable future”.

That leaves the clean-energy business largely dependent on government handouts. Shares in the sector rose after George Bush's state-of-the-union address in January, when he swore to wean America off dependence on foreign oil. They also rallied on hopes that the newly Democratic Congress would spend more money on greenery. Several of those elected, after all, tried to burnish their environmental credentials by running uplifting advertisements of themselves roaming the countryside amid majestic wind turbines.



But what one politician can mandate, another can terminate—and therein lies one of the biggest risks for clean energy. American politicians have periodically allowed a tax break for wind generation to expire, for example. This caused the industry to falter several times, before the credit was renewed again (see chart 2). It is due to expire once more next year. In similar fashion, the shares of European clean-energy firms fell this summer, along with the price of permits to emit carbon dioxide within the EU. The price of permits had fallen because European governments had handed out too many of them to polluters, thus flooding the market.

Voters, too, sometimes lose heart. In the recent elections, Californians, normally a reliably green lot, voted against a proposal to tax oil production to fund research into renewables. Yet clean-energy investors are gambling, essentially, that governments and the taxpayers who fund them will continue to spend lavishly on the industry.

A dramatic fall in the oil price will almost certainly prompt governments to tighten purse-strings, since subsidies become relatively more expensive. Developing new, carbon-free technologies will seem less urgent if there is plenty of cheap oil about. When oil prices fell in the 1980s, governments quietly dropped many of the grand plans for energy independence developed during the oil shocks of the 1970s.

In Mr Liebreich's view, oil-prices below $50 a barrel would undermine the momentum of clean energy. Mr Khosla, the venture capitalist, warned delegates at the conference in San Jose that they needed technologies that are “unconditionally cheaper” than fossil fuels: “If it ain't cheaper, it doesn't scale.”

For the time being, however, keeping pace with demand is more of a worry. Most manufacturers of wind turbines have full order books for the next few years. Executives at Neste, a big Finnish refiner, doubt Europe's output of biofuels can expand fast enough to meet the EU's target. The EU has also had to reduce its target for renewable power, since the industry could not grow fast enough to meet it.

The growth of solar firms has outpaced the supply of high-grade silicon needed to make their panels. Investors are now rushing to finance factories to produce the necessary silicon. Goldman Sachs expects output to double by 2010—raising fears of an eventual crash in prices. In the meantime, solar firms seeking financing are trying to distinguish themselves, either through contracts that assure their future supplies of silicon or through technology that reduces their consumption of it.

The potential for growth, most analysts argue, is clear. But bottlenecks and political setbacks, not to mention technological glitches, will create many bumps in the road ahead. Indeed, fears that the most euphoric investors were overlooking such obstacles seem to have contributed to a sharp fall in clean-energy stocks earlier this year—although they have since recovered much of the lost ground. Such jitters caused several green-energy firms to cancel planned flotations.

“There's legitimate debate about a couple of segments,” says Keith Raab, boss of Cleantech Venture Network. In some instances, valuations accorded to firms with no profits—and little chance of making any soon—were reminiscent of the excesses of the dotcom bubble. As Douglas Lloyd, of Venture Business Research, puts it, “There's too much money chasing too few opportunities. How is it possible that this many solar companies are going to succeed? They're not.”

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California's solar wineries

Dionysus, meet Helios

Nov 16th 2006 | NAPA VALLEY, CALIFORNIA
From The Economist print edition

Solar power is the new vintage

FROM the Honig Winery in the heart of the Napa Valley, vines heavy with grapes stretch all the way to the distant hills. But in their midst stands an odd sight—hundreds of solar panels, installed in August, gently sloping and ringed by a fence. Already the winery's electricity bill has dropped to zero, as the system has produced a surplus of power. Putting them in was “a no-brainer”, says Tony Benedetti, Honig's chief financial officer. “Any business that is a high user of electricity, how could you not consider this?”

So far a few dozen of California's 1,400 or so wineries have gone solar, but “it's going to grow pretty dramatically”, predicts Barry Cinnamon of Akeena Solar, an installer. The state has created extraordinary incentives for businesses and homes to adopt the otherwise unaffordable technology. The Honig unit, which covers a third of an acre (1,350 square metres), cost $1.2m. About $400,000 was repaid immediately as a rebate from Pacific Gas and Electric, a utility. Another 30% will be written off as a tax credit this year, thanks to the 2005 federal energy bill. Then there is another tax credit from the state. Most wineries break even in seven or eight years on solar-power units that should last for decades.

Wineries make an especially good fit for solar power, and not just because going green appeals to their affluent customers. They use lots of electricity—for chilling the juice during the fermentation process, as well as for crushing grapes and bottling wine. Usefully, the panels generate the most power in the summer, whereas wineries use the largest amount of energy in the autumn, after harvest. This means that the wineries can sell their power to California's grid at peak summer rates (when air-conditioners are pumping), and buy it back from the grid more cheaply later.

The main hurdle is cost. In just two years, solar panels have gone up in price by over 50%, says Chris Bunas of SolarCraft, another Californian installer. That is because of a shortage of silicon, the key ingredient. New technologies, such as “thin-film” panels, could cut prices.

Another problem is space. At Honig, several rows of vines had to be chopped down. Some wineries have put panels on their roofs. At Cline Cellars, a Sonoma winery that has turned its rooftop solar, the only maintenance problem is dust, which can block out sunlight. The panels have to be hosed or brushed off a few times a year, says Fred Cline, the owner. Yet even on cloudy days they still produce plenty of electricity.

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Hedge funds

Rolling in it

Nov 16th 2006
From The Economist print edition

bluegreenpictures

Why investors should kick up a fuss about hedge-fund fees

THERE is an old Wall Street story that can be adapted for the modern world of hedge funds. A young hedge-fund trainee is taken to the harbour. “Here”, says his boss, “are the partners' yachts. And over there are the yachts of the bankers who lend to us.” The naive youth replies: “But where are the customers' yachts?”

Recent weeks have shown how alluring a berth on that bounteous marina is. Morgan Stanley, a big investment bank, has bought stakes in three groups, Avenue Capital, FrontPoint Partners and Lansdowne, at a total cost believed to be more than $1 billion. Two former American treasury secretaries, Larry Summers and John Snow, have discovered hedge-fund lucre, as has another former Washingtonian, Chelsea Clinton, the ex-president's daughter. In the hope of tapping new sources of capital, Fortress Investment Group, which offers both hedge funds and private equity, has announced plans to float 10% of itself on America's stockmarket. Marshall Wace, a British manager, has launched a €1.5 billion ($1.9 billion) hedge fund on the Euronext exchange in Amsterdam.

But the flurry of activity raises two big questions. First, everyone knows that hedge-fund managers are rolling in it; some made more than $1 billion last year. Investment banks also earn a big slug of their income from lending to, and trading for, hedge funds. Most new investors back the sector via funds-of-funds, which collect a second layer of fees. If industry insiders make so much from the industry, can that leave anything for the clients? Where are their yachts?

Second, if investment banks are buying or launching hedge funds, the sector itself is expanding into loan-making and private equity, and mutual funds are adopting hedge-fund techniques, is there any sense in talking of a separate hedge-fund industry any more? Asset management, once so tribal, is becoming a giant melting-pot.

The long and the short of it

Already it is fiendishly hard to define a hedge fund. At best, one can outline a few key characteristics. Hedge funds are private pools of capital that are lightly regulated, often borrow to enhance returns and are partly paid on the basis of performance. The term “hedge” (from hedging your bets) derives from the aim of making money whether a market goes up or down. This ability to bet on falling prices (“going

short") distinguishes them from traditional "long-only" funds, which profit only if prices rise.

Enthusiasts say the greater variety of tools at their disposal gives them an edge. Stanley Fink of Man Investments, one of the largest hedge-fund groups, uses the analogy of having a full range of golf clubs rather than just one.

That flexibility appeals to pension funds. In the 1990s, many pension funds made far too big a bet on equities, a gamble that went disastrously wrong in the 2000-02 bear market. As pension funds sank into deficit, they started looking for alternative sources of return.

Hence the astonishing growth of hedge funds. In 1990, according to estimates by Hedge Fund Research (HFR), a data provider, there were just 610 funds controlling some $39 billion of assets. By 2000 there were 3,873 funds with $490 billion. The latest estimate is over 9,000 funds, with $1.3 trillion at their disposal.

Moving into hedge funds has been part of a deliberate diversification into "alternative assets", a category that includes property, commodities and private-equity investment. Mark Anson, chief executive of Hermes, a British group that manages pension assets for BT, a telecoms operator, says hedge funds offer a source of return that does not necessarily move in step with share and bond markets.

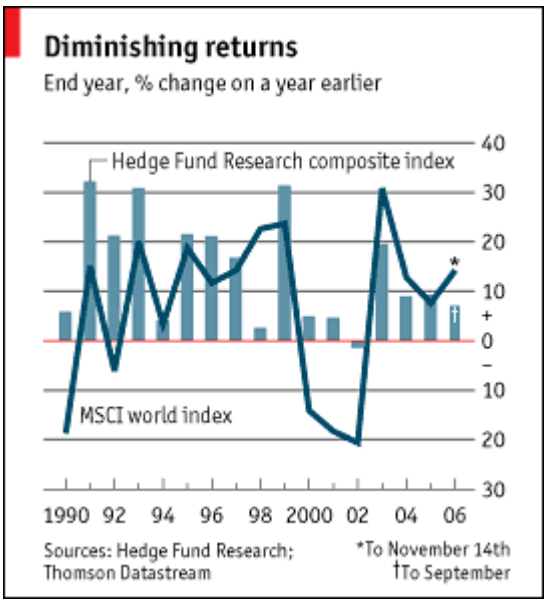
A genuinely diversified source of return is the one "free lunch" available from the investment world. If it can be found, it will improve the trade-off between risk and return. That is why investors are willing to pay the high fees (often 2% annually plus a fifth of all profits) that hedge funds charge.

And the hedge funds have done a good job of protecting investors. The worst year for the sector, according to HFR, was 2002, when the index fell 1.5%; there has been only one month since 1990 when the sector lost more than 3.5%.

But Narayan Naik of the London Business School gives warning that hedge funds might be more closely correlated with other investments then they appear to be. He says pension funds have been advised to move into hedge funds by consultants, who are impressed by hedge funds' favourable risk-return trade-offs.

The problem, says Mr Naik, is that the consultants had to rely on past data. And those were very flattering. During the 1990s, most asset prices soared. The industry was dominated by "global macro" managers such as George Soros who took big bets on currencies and stockmarkets, using borrowed money. Measured returns for the sector were boosted by survivor bias: failed funds ceased to be counted in the indices.

In recent years, returns have been much less impressive (see chart). In the 1990s, the compound annual return from HFR's composite index was 18.3%; since 2000, that return has been just 7.5%. Not surprisingly, that has disappointed some investors. A global survey by Mercer Investment Consulting found that only 23% of pension funds were satisfied with their fund-of-hedge-funds investments.



Alpha pay for beta performance

Of course, it has been much more difficult to make money in markets since the dotcom bubble burst in 2000. But that only shows hedge-fund returns are not just dependent on skill (“alpha”, in the jargon) but on general market movements (“beta”). Mr Naik says that hedge-fund returns have been increasingly based on beta in recent years. Hedge-fund managers have every incentive to take this route, since they take a percentage of all profits, however they are derived. But beta can be obtained at very low cost via index-tracking funds. Why pay hedge-fund prices?

The smart (or big) money has already responded to these problems. ABP of the Netherlands is the largest pension fund in Europe with €200 billion of assets. Edwina Neal, its chief investment officer, says the group has around 3% of its investments in hedge funds, making it one of the industry's biggest backers. That power gives ABP the ability to place greater emphasis on performance, to control fees and to insist on hurdle rates before paying them. ABP also looks for specialist hedge funds whose returns are not closely related to the rest of its portfolio.

Such investments might seem to be an example of a “free lunch”. But can everyone dine from this table? Uncorrelated hedge funds tend to have niche strategies and there is a limit to the amount they can invest. Too much money tends to dilute returns, as happened to one sector (convertible arbitrage) in 2005. Furthermore, niche strategies tend to invest in illiquid assets, such as exotic options. Assets of this sort appear to move differently from mainstream shares and bonds because their price moves infrequently. But when bad news hits stockmarkets, illiquid assets can be hit extremely hard. Correlations increase substantially.

Hedge-fund managers are well aware of the limits of specialising in niche products. Some simply close to new investors after reaching their target for funds under management. But others want to keep growing. A number develop private-equity or banking characteristics, by providing capital directly to companies or making loans. Some are diversifying into multi-strategy funds, which invest across a range of sectors. Others have started long-only funds, thereby opening up a much bigger market. As Peter Harrison of MPC investors, a fund manager, says: “There's $1 trillion or so in hedge funds but $90 trillion of long-only money and that's the big prize.”

While hedge funds are expanding, traditional groups are moving into their territory, too. Some, like Morgan Stanley, are doing so by acquisition; others, such as Barclays Global Investors and Gartmore, have built up in-house franchises. A change in mutual-fund rules applicable across the EU, known as UCITS III, has meant that hedge-fund practices are also available to retail investors. Products known as 130/30 funds (which can go 130% long and 30% short) offer some of the flexibility of a hedge fund—albeit with some of the fees, too. So it may well be that the increasingly blurry distinction between hedge-fund managers and less racy traditional managers will become obsolete. “In three to four years' time, we may not be talking about hedge funds as an element of the portfolio but about putting money into equities and then backing good managers, however they operate,” remarks Nadja Pinnavaia of Goldman Sachs Asset Management.

As the industry matures, it is becoming more concentrated. Hedge Fund Intelligence, a data provider, reckons the top 20 funds control a third of the industry's assets. The funds of funds, such as those at Man Group and UBS, are the largest. Among the direct managers, HFI says there are four American groups with more than $20 billion of hedge-fund assets (Goldman Sachs, JPMorgan Chase, Bridgewater and D.E. Shaw) and another four with over $15 billion (Farallon Capital Management, Och-Ziff Capital, Barclays Global Investors and ESL Investments).

The growing power of the most popular hedge-fund managers means some are extending the initial lock-up and notice periods before investors can withdraw their money. This might be fine until disaster strikes. And disasters do happen—such as the recent 65% loss in one month by Amaranth Advisors, a Connecticut-based hedge fund whose top trader gambled on natural-gas prices. But the image of hedge funds as a high-stakes casino is rather unfair; most hedge funds quietly give up through lack of interest rather than collapsing spectacularly.

Hedge funds may have acted to stabilise markets by increasing liquidity and by betting on both falling and rising prices. It is surely no coincidence that the recent low volatility of equity, bond and currency markets has coincided with hedge funds' explosive growth.

Hedge funds' boosters and detractors both exaggerate. Hedge funds are not the panacea for every

pension-fund deficit, nor are they the cause of every ill in the financial markets. They are like a fast-growing adolescent, sometimes boisterous, sometimes clumsy but still developing. Where skill does exist, clients will probably find that managers get the bulk of the benefits. But as long as clients blindly believe in that skill, they will pay for the hedge funds' yachts.

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Stock exchanges

A war on two fronts

Nov 16th 2006 | BRUSSELS, FRANKFURT, LONDON AND TOKYO
From The Economist print edition

Clients and regulators are putting pressure on exchanges

"THIS is like playing chess with all the pieces moving at the same time," Judith Hardt, secretary-general of the Federation of European Securities Exchanges, said on November 14th. She was lamenting the shifting horizons of those she represents who "keep falling in love with each other and then hating each other."

Prophetic enough. The next day Germany's Deutsche Börse withdrew its (repeatedly snubbed) offer to merge with the pan-European Euronext, clearing one obstacle to Euronext's proposed union with the New York Stock Exchange (NYSE). The same day a group of big investment banks fired its latest broadside in the war over trading fees by announcing plans to sidestep the exchanges with their own platform spanning Europe. The goal, the banks say, is to inject more competition into share trading and ultimately to lower costs, which can be up to eight times higher than in America.

Hardly a week goes by without news of more upheaval in Europe's trading dens. The pressure for change is coming from two powerful forces: regulators and customers. Similar forces have already pushed America's exchanges to cut trading fees and invest in new technology.

On both sides of the Atlantic exchanges have sought to protect their heritage with plans to join forces, which would enable them to share trading systems and provide deeper pools of liquidity to their customers. Recently they have also begun to think globally. The Tokyo Stock Exchange (TSE) has held talks on a potential tie-up with the NYSE and has also discussed collaboration with both the London Stock Exchange and Deutsche Börse. The TSE has been humiliated in the past year by a string of mishaps; Japan's regulators have pushed it to spend money on technology to increase trading capacity and regain the trust of its users.

But are such attempts, with merger plans that seem to drag on and on wherever you look, likely to be successful enough to keep the competitive bloodhounds at bay? And are those more likely to go it alone, such as Deutsche Börse, capable of surviving as they insist they are?

One of the forces bearing down on them in the EU is the whip-cracking Charlie McCreevy, the commissioner in charge of the single market. He is now armed with a looming piece of regulation called the Markets in Financial Instruments Directive (MiFID), which comes into effect from November 2007. It aims to increase competition and reduce costs. Already MiFID is pressuring exchanges to change their ways. Last week, under threat of retaliation from Mr McCreevy if they failed to act, Europe's exchanges signed a pact to improve transparency in the clearing and settlement of trades by sharing information on pricing and easing access for investors.

While regulators are squeezing from one side, the exchanges' clients—particularly the investment banks, brokerages and hedge funds—are squeezing from the other. With trillions of dollars and frenetic trading habits, they resent the fees the exchanges have been charging them and increasingly look for alternatives (some of which they are creating themselves). In recent weeks several new entities have sprung up in Europe to cater to them. These include Chi-X, a London-based joint venture that claims it will offer rapid, low-cost trading in European stocks; and Equiduct, an all-electronic, pan-European exchange to be based in Belgium.

And now the banks. Details of their plan remain hazy but its announcement was enough to trigger a slide on November 15th in the share prices of Europe's leading exchanges, which have been steadily climbing for years (see chart). Citigroup, Credit

Suisse, Deutsche Bank, Goldman Sachs, Merrill Lynch, Morgan Stanley and UBS say they will form a consortium to trade equities across Europe, but have yet to decide whether to buy another trading venue or build their own. Many of these banks launched a similar venture in America two months ago.

A spokesman for Deutsche Börse reels off the names of start-up trading platforms that have come and gone. In each case, he notes, they did not drain enough trading from established exchanges to pose a big threat. But those behind the new ventures are counting on changes in regulation and technology to work in their favour. If that happens, the exchanges will soon have to stop flirting and start merging.

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About sponsorship

Buttonwood

The rich are different

Nov 16th 2006
From The Economist print edition

Is that an asset-price bubble or just the fizz of Dom Pérignon?

AN AUCTION on November 8th of impressionist and modern art in New York brings in a record $491m. A yet-to-be-completed Manhattan apartment block nets $1.4 billion in unit sales. The finest Bordeaux wines from 2005 sell for prices that are four to five times higher than those of the previous vintage.

Those stories look like the ingredients for a boom as heady as the roaring 1920s or the “greed is good” era of the 1980s. And where there is a boom, there is usually a bubble about to pop.

Speculative excess in the stockmarket has tended to be associated with booms in luxury goods and record prices for trophy assets. Remember how Alan Bond, an Australian businessman, paid a record $54m for a Van Gogh within weeks of the 1987 stockmarket crash?

But perhaps this bubble indicator needs revising. Trophy asset prices may not simply be a function of financial-market conditions but of the huge dispersion of incomes that has occurred in the past 20 years. The income share of the top 1% of the American population has roughly doubled since the start of the 1980s.

In other words, there are a lot more rich people about. And since the supply of prestige assets must be, by definition, limited, the price of such assets is sure to rise. What is the point of being rich if you cannot drink the finest wines while gazing at the world's most famous artworks on the walls of your penthouse flat?

If this were just a case of hedge-fund managers and bankers spending their bonuses, then the bubble argument would have great power. Bonuses only tend to be large when asset prices are rising.

But just as important as the “masters of the universe” are the rich from the developing world, who are buying football clubs and country estates with cheerful abandon. And the rapid growth rates of developing economies mean that the ranks of the plutocrats will keep growing. Whereas fortunes were made from technology in the late 1990s, they are being made from commodities today.

Political turbulence may occasionally reshuffle the members of the elite, as Mikhail Khodorkovsky learned to his cost when Russia's President Vladimir Putin locked him up and took away his company. But there will always be another oligarch to take the place of the fallen.

Whereas income disparities have provoked lots of political debate, there has been less analysis of the economic effects. Ajay Kapur of Citigroup has described America as a “plutonomy” where the top 20% account for nearly 60% of all consumption while the bottom fifth spend just 3%. Accordingly, Mr Kapur says the rich matter far more than the “average” consumer; that may explain why American demand was so robust in the face of higher petrol prices.

And the rich are cushioned from the effects of a housing slump. Mr Kapur notes that less than a fifth of the assets of the top 10% of American earners are tied up in their main homes; for other groups, houses comprise 40-45% of their assets.

So it would probably take a sharp drop in the stockmarket, or a general business collapse, to hurt the rich. This is good news for the luxury-goods and art markets and implies the top of the property market can be detached from the rest.

But it also means we need some different bubble indicators for the financial markets. Instead of the rich, we should be looking at the broader population.

Buttonwood would like to suggest two tried-and-trusted canaries for this particular coalmine. The first is television. At the height of the dotcom boom, every gym TV seemed to be tuned to CNBC, a financial channel; exercisers did not want to miss out on the latest stock tips as they pounded the treadmill. British TV ran a gameshow comparing the performance of contestants' portfolios over a matter of weeks, a period so short as to ensure the results were in effect random.

The second is cocktail-party conversation. Peter Lynch, a successful Fidelity fund manager, said he knew markets were in a bad way when people would edge away when he told them his profession. When markets were heating up, they would ask him for share tips. The sure sign of a bubble was when they couldn't wait to give him their own tips.

Residential property scored highly on both bubble indicators a couple of years ago. But the stockmarket is barely causing a bubble-meter twitch in either TV or party conversation; retail investors are still recovering from the trauma of 2000-02. As for the rich, they are, as F. Scott Fitzgerald said, different from you and me. Watching their purchases may be entertaining but of little educational value.

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Citigroup in China

Start of the long march

Nov 16th 2006 | BEIJING AND HONG KONG
From The Economist print edition

Charles Prince gambles on a rickety Chinese bank

IF, AS seems likely, consumer banking in China takes a great leap forward, Guangdong Development Bank has obvious appeal. It has 13m customers, 500 branches, a strong franchise in the manufacturing hub near Hong Kong and a national licence that could permit years of formidable growth. So Citigroup's chief executive, Charles Prince, must have been thrilled to fly into Hong Kong this week on unrelated business to find that a bidding consortium led by his bank was about to win control of Guangdong after a bruising auction that lasted more than a year. It beat Société Générale, a French bank.

The deal marks the first time foreigners have been allowed into the driving seat of a big, potentially national, Chinese bank. But the main reason the authorities gave Mr Prince and his partners such access is because Guangdong is a wreck. Its most recent audited statement in 2003 showed that non-performing loans represented an alarming 22% of its portfolio. A report in the government-backed China Daily agency put non-performing loans at 25% in 2005. That suggests its performance may be getting worse even as China booms.

To win Guangdong, Citigroup initially bid for outright control at the request of the local authorities. The offer was withdrawn under national government pressure because of limits on the stake of any foreign investor in a Chinese bank to 20%, and of total foreign investment to 25%. An awkward consortium was assembled which includes IBM, China Life (the country's biggest insurance company), State Grid (an electrical utility), and Citic Trust (a government-backed holding company). Citigroup's lead role is implicit but not explicit, which may do it no favours when it attempts to bash Guangdong into shape.

The group is expected to pay $3.1 billion for 85% of Guangdong. Typically banks are valued as a multiple of book value. Realistically, Guangdong may have no book value or even a negative one. But the bidders are betting on opportunity, not an institution. “This is not a banking deal,” says a lawyer whose client lost out in an earlier round of bidding. “It is a China deal.”

Many banks are eager for such deals but their ways of going about it differ. Some have invested passively, praying that the Chinese banks manage themselves well. Bank of America bought 9% of China Construction Bank in 2005 for $3 billion; that stake has tripled in value. Goldman Sachs has made a similar fortune with Industrial and Commercial Bank of China. Other big banks believe that pouring money into any institution with credit and operating problems—which is the case for every Chinese bank—is madness if it doesn't also bring control. That has been the view of JPMorgan Chase.

Until now, Citigroup has taken a more ad hoc approach. It has half-a-dozen branches of its own and a franchise serving multinationals. It has a joint venture with Shanghai Pudong Development Bank, a small regional bank that allows it to issue credit cards. Citigroup plans quietly to lift its stake in that bank from 5% to the maximum 20%.

Its first challenge with Guangdong will be to improve operations. IBM, which has a huge business serving banks but has had its own sales challenges in China, will presumably be of help transforming Guangdong's lousy IT systems. It is seen as a temporary partner and Citigroup is thought to have the first right of repurchase for IBM's shares.

Ideally, Guangdong would be folded into Citigroup, with branches fanning out across China to offer services to the growing middle class, investment products and corporate banking, such as payroll and cash management. For Mr Prince, getting Guangdong (and thus China) right could, by itself, kickstart what has so far been an undistinguished tenure for him. If not, it could be a great leap backwards.

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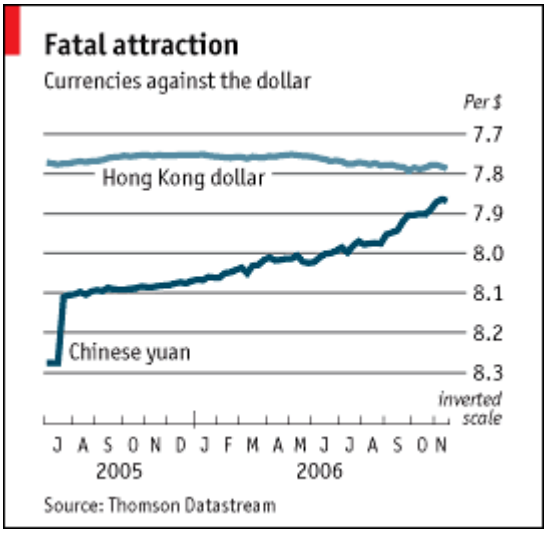
Currency pegs in China

Yuan for all, all for yuan

Nov 16th 2006 | HONG KONG
From The Economist print edition

Is it time for China's currencies to get hitched?

THE Chinese yuan has picked up the pace over the past couple of months, rising at an annual rate of almost 7% against the American dollar since September—four times as fast as over the previous 14 months since it broke its link with the dollar. If this continues, the yuan could soon be worth more than China's second currency, the Hong Kong dollar, which is still firmly pegged to the greenback.



On November 13th the yuan hit a new high of 7.864 to the dollar, putting it within a whisker of the Hong Kong dollar's trading band of HK$7.75-7.85 against its American counterpart. This has prompted some market speculation that as the yuan approaches parity with its traditionally stronger neighbour, which looks possible by the end of the year, Hong Kong will abandon its dollar peg and instead tie itself to the yuan. But not only is the dollar divorce unlikely in the near future, such a marriage would be one made in hell.

Hong Kong's peg to the dollar has survived 23 years of political and economic turmoil, more than twice as long as China's dollar peg lasted. During the 1997-98 Asian crisis the Hong Kong Monetary Authority (HKMA) fiercely defended the peg against massive speculative attacks at the cost of sky-high interest rates, a property-market collapse and severe deflation. Today the Hong Kong dollar is under upward, not downward pressure, but Joseph Yam, head of the HKMA, has repeatedly said that the rising yuan will not lead to a change in the Hong Kong dollar's peg.

Currency traders hope otherwise. In theory the dollar peg means that interest rates in Hong Kong should be the same as in America. Yet three-month rates are 120 basis points lower than those in America, which partly reflects the suspicion that the currency could break ranks with the dollar and rise in line with the yuan.

However, there is no economic reason for the Hong Kong dollar and the yuan to be fixed at a one-for-one rate. For one thing the yuan is not fully convertible, so it cannot be an anchor currency. China is gradually relaxing capital controls but it still has a long way to go. Hong Kong would lose its own fully convertible international currency by being tied to it.

Second, the two economies differ hugely in their economic structure and stage of development and thus are hardly an optimal currency area. China is heavily dependent on manufacturing whereas Hong Kong concentrates on financial services. It is true that Hong Kong's economy has become more closely integrated with the mainland through trade, investment and tourism: its trade with mainland China is much bigger than that with America. A recent study by the HKMA finds that Hong Kong's business cycle also moves more closely with China's than it used to, but it is still more closely correlated with America's economy.

Third, China needs a more independent monetary policy to control its red-hot economy, which means it must let the yuan rise. Hong Kong, in contrast, has not long emerged from a period of prolonged deflation. And most local economists reckon that currency stability is more important than monetary-policy flexibility. The anchor has helped Hong Kong to weather international financial storms and underpinned the city's competitiveness as a financial centre.

Last but not least, Hong Kong, unlike China, is not under foreign pressure to allow its currency to appreciate. If the yuan climbs further, Hong Kong would be happy to gain competitiveness in the region, boosting exports as well as inward investment and tourism from the mainland.

Looking ahead, as Hong Kong and mainland China become more economically and financially integrated, it seems inevitable that the Hong Kong dollar will eventually be replaced by the yuan. However, a merger will not make sense until the yuan becomes fully convertible. Gunshot marriages rarely work out well.

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Payments

Panhandlers beware

Nov 16th 2006 | NEW YORK
From The Economist print edition

Credit-card companies go downmarket to take on the last domain of cash

PICTURE a world where consumers pay for everything—from hamburgers to houses—with plastic. Sound far-fetched? Not to credit-card companies like Visa, MasterCard and American Express. Ten years ago, American consumers paid cash or cheques for 71% of their purchases. Today, according to Nilson Report, a trade publication, more than half are charged to cards. Cash tills—and trouser pockets— are in danger of becoming redundant.

That, of course, will not be unalloyed good news to consumers—or panhandlers. Already, the average American household has over ten cards of one sort or another, and many people are swimming in debt.

Super Stock

Tomorrow's loose change

But the credit-card companies have realised that the last holdout of cash is the small purchase—newspapers, bus tickets, cigarettes. So MasterCard, Visa and others have introduced “contactless cards” for purchases under $25. With a tap or a wave, the cards wirelessly beam data to a receiving device on the shopkeeper's counter. The process takes less than two seconds, meaning fewer queues. Retailers like them because there is a lower risk of theft and fewer notes and coins to be totted up and trundled to the bank each day. Also research shows that people tend to spend more when they pay with plastic.

The market for such cards is still tiny. According to Nilson Report, there are 21m contactless cards in America, compared with 1.5 billion credit cards. But it is early days. Already, fast-food chains, cinemas and sports venues, such as Yankee Stadium in New York, are welcoming them. The next step is the prospect of embedding contactless chips into mobile-phone SIM cards. Such systems are being tested, though there are tensions over whether the phone company or the credit-card company would get the bulk of the spoils.

Card companies are also taking aim at bigger transactions where cheque-writing is customary. In America they have signed deals with property-management companies to allow residents to use credit cards for rent, mortgage instalments and even the down-payment on a house.

Another gaping hole in the card-carrying firmament is among those who do not have bank accounts, especially new immigrants and the poor. So card companies are offering “prepaid” cards—in effect, debit cards that can be loaded with money (at petrol stations, convenience stores and the like) without a bank account. Visa estimates that there are 80m “unbanked” consumers in America and that they pay $1.5 billion in cheque-cashing fees a year.

Dozens of state governments—among them Texas, Colorado and Georgia—are using Visa- and MasterCard-branded prepaid cards to provide child-support and other government benefits. This cuts fraud and saves governments money. Ohio, which uses a Visa-branded card to disburse unemployment benefits, reckons it saves nearly $2m a year since it switched to plastic. Some employers, too, are depositing salaries for staff without bank accounts directly onto pre-paid cards. Cash, once king, may in time be dethroned.

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Economics focus

Third thoughts on foreign capital

Nov 16th 2006
From The Economist print edition

If it doesn't kill you, financial globalisation will make you stronger

THE next great globalisation, according to Frederic Mishkin's new book* of that name, will be financial in character: the flow of foreign money into stocks, bonds and banking in emerging economies. A recently appointed governor of the Federal Reserve, Mr Mishkin makes a clear and compact case for cosmopolitan capital; and his footnotes (all 55 pages of them) weigh and tally a wealth of economic research. But the title of his book is a bit odd: wasn't cross-border finance the last, rather disappointing, globalisation?

That, certainly, was the verdict of a 2003 review† of the evidence by a quartet of economists (Eswar Prasad, Ken Rogoff, Shang-Jin Wei and Ayhan Khose) who looked at almost as many studies as Mr Mishkin. They found no robust proof that financial globalisation helped countries to grow more quickly. The song was not original, but the singers were impossible to ignore: all four were prominent economists at the IMF; Mr Rogoff, indeed, was the fund's chief economic adviser. It was as if the Fed's economists had failed to find any virtue in low inflation.

Now the same authors are offering another reappraisal of financial globalisation††, which Mr Prasad presented earlier this month at the IMF's annual research conference. The next globalisation is probably going to happen, he said (money has a habit of seeping across borders, whether you like it or not), and it may be great. But not for the reasons you might think.

It's not about the money

An economist's first thought on financial globalisation is straightforward: capital should be free to flow “downhill” from high-income countries where it is abundant to poorer countries where it is scarce. By importing savings from abroad, poor countries can invest more than they are able to set aside from their own meagre output. But Mr Prasad and his colleagues reckon that this direct benefit of foreign capital—the extra money it provides—is “arguably” worth less than a number of indirect ones; namely a deeper financial system, better-run companies and a more disciplined macroeconomic policy.

Thanks to the first of these indirect benefits, “financial deepening”, open countries enjoy bigger, more liquid stockmarkets and a lower cost of equity. They also benefit from more sophisticated banking. Foreign lenders are often stronger and better run than their local rivals. They introduce new products and know-how and they give dissatisfied depositors somewhere else to take their custom, forcing local banks to raise their game. Moreover, foreign banks accustomed to sound regulation, prudent oversight and honest accounting in their home countries may lobby for the same things abroad.

The four authors also think that cosmopolitan capitalists can police companies and officials better than locals can. Foreign investors may have a better nose for boardroom shenanigans and a strong incentive to protect minority shareholders. A recent study of 365 firms listed on the Thai Stock Exchange by Sudarat Ananchotikul of the University of California, Berkeley, found that foreign institutional investors holding a minority stake help to ensure that the company is run for the benefit of all its owners. (That said, when foreign companies buy controlling stakes in Thai firms, they are as keen as anyone else to exploit minority shareholders, she finds.)

Mr Prasad also highlights a third side-benefit. Capital flows should improve a country's macroeconomic stewardship by rewarding prudence and punishing profligacy. In practice, open countries do seem to achieve lower inflation—though there is scant evidence that they run smaller budget deficits.

If these indirect benefits do matter, it may explain why Mr Prasad and company failed three years ago to prove a link between the migration of capital and growth. Like other researchers, they sought to distil the impact of financial openness by straining out the influence of other factors that might lift growth—such as financial depth, institutional strength and macroeconomic stability. But if foreign capital promotes these three virtues, then the study may have inadvertently strained out much of the benefit of financial globalisation.

There is, however, “a fly in the ointment”, Mr Prasad says. Even if it has these indirect pay-offs, foreign capital can also make mischief in countries that are not ready for it. Overseas investors show little mercy to countries where public spending gets out of hand, the currency gets out of line, the banks are poorly supervised or companies rip off outside owners. Mr Prasad thus lays out several “thresholds” that emerging economies should cross before they open up. What are they? A country's financial system should be quite sophisticated, he says; its companies fairly well run; and its macroeconomic policies reasonably disciplined.

Does this list sound familiar? As Mr Prasad points out, there is an awkward paradox in his findings. His checklist of “thresholds” echoes his catalogue of “indirect benefits”. In short, the things financial globalisation strengthens are also the things a country needs to have in place in order to benefit from it.

Mr Mishkin argues that globalisation itself stimulates the reforms needed to make it work. That is often true of trade in goods, but it is sadly not always true of trade in assets. “Poorer countries must let go of the idea that financial infrastructure and wealth can be built up when the countries remain closed off to the rest of the world,” he writes. But Mr Prasad's more ambivalent take suggests poorer countries, lacking financial infrastructure, might want to hang on to that idea a bit longer.

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* “The Next Great Globalization” (Amazon.co.uk). Princeton University Press, 2006.

† “Effects of Financial Globalization on Developing Countries”. IMF Occasional Paper 220.

†† “Financial Globalization: A Reappraisal”. IMF Working Paper WP/06/189.

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Award: Philip Coggan

Nov 16th 2006
From The Economist print edition

Philip Coggan, our capital-markets editor, was named Investment Journalist of the Year in the State Street 2006 Institutional Press Awards in Britain. The award was made for articles written while he was at the *Financial Times*.

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Genetics

Cracking the Neanderthal code

Nov 16th 2006
From The Economist print edition

Two new studies show how to sequence the genome of an extinct species

RECREATING dinosaurs may be the stuff of science fiction—but scientists have for some years been able to extract information from the remains of species that no longer walk the Earth. Unfortunately this evidence is often in the form of tiny, jumbled snippets and it is frequently contaminated. Two new ways to patch the oddments together and distinguish genuine from false information are reported this week. Scientists intend to use the techniques to produce the complete genome of a creature that is not only extinct but also happens to be their closest relative.

When humans first emerged as a species they shared the planet with many types of ape. The fossilised remains of one such species were discovered in the Neander Valley in Germany some 150 years ago. Neanderthal man, as the species has come to be called, was shorter and stockier than humans. The evidence suggests that he was a cousin rather than an ancestor of humanity. Mitochondrial DNA extracted from the bones of Neanderthals does not resemble DNA from any known modern humans, so scientists have concluded that there was no interbreeding between the two, which is what distinguishes one species from another.

Nevertheless Neanderthal man is thought to be man's closest relative. If scientists could recreate his genome, the strings of billions of letters that spell out how to build and run a Neanderthal, they would be able to pinpoint the precise difference between the two species. Moreover, by comparing the two genomes, they could see what makes people human. Until now many researchers have argued that it would be impossible to sequence the entire genome of an extinct creature because the samples are so degraded. How could so many tiny fragments of DNA be pieced together? And how would it be possible to check whether the jigsaw pieces had been assembled correctly?

Never say never

Two teams of researchers appear to have solved these problems. The first, led by Svante Pääbo of the Max Planck Institute for Evolutionary Anthropology in Leipzig, Germany, has managed to sequence more than 1m letters of Neanderthal DNA. It reports its results in this week's issue of *Nature*. Meanwhile in this week's issue of *Science*, a team led by Edward Rubin of the Lawrence Berkeley National Laboratory in California reports that it has also recovered large tracts of Neanderthal DNA. Although in total the team

has unearthed far fewer letters (some 65,000) than its competitors, its discoveries are significant because they focus on specific genes: that is, strings of DNA that are several thousand letters long.

The technology employed by Dr Pääbo and his colleagues is extraordinary because it is 100 times faster than previous techniques. The researchers used “pyrosequencing”, a process which breaks up the DNA into short chunks and then shakes them up in a mixture of water, a special silicone-based oil, a large quantity of tiny plastic balls and chemicals capable of duplicating DNA. This mix is then applied to a tiny chip with 1m wells in it. Get the conditions right and the result is that the wells each contain just one sort of DNA molecule. These can be analysed by a technique that uses fluorescence to read the sequences of the letters that compose the molecules. It is fast because many batches can be done at the same time and the whole process can be automated.

What is more, the method can make sense of the short fragments of DNA that are all that remain in the crumbling bones of a Neanderthal specimen. This was no mean feat: the team tested more than 70 bones and found just one, a thigh bone found in a cave in Vindija, Croatia, that was in good enough condition for the technique to succeed. To reassemble the resulting pieces of information into a coherent picture, Dr Pääbo and his colleagues compared their pieces with the human genome, which has been fully sequenced. By mapping stretches of Neanderthal DNA to its human equivalent, the researchers were able to complete bits of the jigsaw.

Dr Rubin and his colleagues used what is called a “metagenomic” approach. This has one great advantage: it can be used to target specific areas of interest. The researchers propagated individual DNA fragments in the traditional way, in bacteria, to create a gene library; they also developed a method for pulling out specific sequences from the library, providing an easy way to study any gene of interest. They found 29 Neanderthal sequences that are similar to those of humans and concluded that Neanderthals and humans are likely to be at least 99.5% identical, genetically speaking.

The work continues to sequence the entire Neanderthal genome and to check that the sequence is correct. As with the human genome, the race is between two teams using two different techniques: one method is rough-and-ready, the other slow-and-steady. Dr Pääbo says he will have a rough draft of the entire Neanderthal genome within two years, and that he has devised a way to make pyrosequencing ten times faster. The researchers propose to sequence the genome six times, allowing them to identify any mistakes. On its way to being fully decoded the human genome was sequenced, on average, ten times.

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Environment

Seeing the wood

Nov 16th 2006
From The Economist print edition

A new way of counting trees finds more of them than was thought

Get article background

THE clearing of forests for agriculture or logging is progressing at a worrisome rate around the world. But that is not the whole story. A new study shows that, in richer countries at least, many more trees are springing up than are being felled.

Researchers led by Pekka Kauppi of the University of Helsinki in Finland sought to identify exactly how much carbon is stored in the world's forests. They analysed reports on the state of forests in 50 countries in 1990 and 2005 compiled by the United Nations Food and Agriculture Organisation. They also used information contained in national databases dating back hundreds of years.

Instead of merely estimating the area of forest in each part of the world (the traditional way of measuring forest cover), they took into account the volume of timber, the weight of the organic matter and the density of trees to calculate what they dubbed the “forest identity”, a measure of the carbon-capturing capacity of forests. The results, published in the *Proceedings of the National Academy of Sciences*, show that in all the countries that have a GDP per head of $4,600 or more—making them richer than, say, Chile—forests are recovering. Some countries that are poorer than this but which have policies to promote tree growth also showed an overall increase in their capacity to sequester carbon dioxide.

Globally, the total number of trees and associated organic matter has fallen year on year, in some places for as long as records have existed. Poor management in Brazil and Indonesia has been a particular problem: both countries lost greater volumes of timber than America and China even though America and China harvested more wood.

But elsewhere the picture was less gloomy. Tree cover in tropical areas such as El Salvador and the Dominican Republic has grown in recent years. Russia and Scandinavia are gaining trees. In fact all major temperate and boreal forests are expanding. The researchers calculated that the “forest identity” had increased over the past 15 years in 22 of the world's 50 most forested countries.

Forests are also gaining ground in the world's two most populous countries, India and China. Although it is still a poor country, India's forests are no longer shrinking. In China the density of forest has fallen since 1949 in many parts of the country but the area of its forested land has steadily risen. The net result is an increase in the volume of China's standing timber. Other Asian countries that have gone from deforestation to afforestation include South Korea and Vietnam.

The researchers argue that the trend is partly the result of social changes that occur as countries develop and become wealthier, such as the movement of rural dwellers to cities. Urbanisation decreases the likelihood of trees being felled for heating and building. As the world becomes more prosperous, it also becomes woodier. News of the death of forests appears to have been greatly exaggerated.

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Alternative fuel

Gas guzzler

Nov 16th 2006 | BERLIN
From The Economist print edition

A saloon car powered by liquid hydrogen is unveiled

HYDROGEN holds out hope as an alternative fuel to petrol for transport because there is plenty of it about in the form of water and no greenhouse gases are produced when it is burned. Most big carmakers are examining how it might best be used. Much of the work focuses on designing hydrogen fuel cells that would generate electricity to drive the car, at first in combination with a petrol engine. This week a German carmaker, BMW, revealed an alternative approach: an otherwise normal saloon car that can run with a hydrogen-powered internal-combustion engine.

The car has two fuel tanks, one containing petrol and the other hydrogen. The idea is to give drivers the choice of when to use which fuel. Apart from some subtle badges, the only clue to the car's dual life is the presence of two fuel caps. At selected petrol stations in Germany and America, customers will be able to refill one of their two tanks with liquid hydrogen.

A computer manages operations ranging from refuelling to switching between fuels, which can be done at the touch of a button on the steering wheel; the transition is almost seamless and considerably less disruptive than changing gears. To accommodate these functions, the power of the car's engine, a relatively standard-issue V-12, has been cut slightly. But BMW's engineers think that they can regain this lost performance by redesigning the engine to have direct fuel injection and by turbocharging it. The new car has modified fuel injectors that are capable of running with either hydrogen or petrol, and steps have been taken to prevent the fuel damaging the pistons and other metal surfaces within the engine.

Hydrogen contains more energy for its mass than petrol but it also weighs a lot less. Overall, this means that a greater volume of hydrogen is needed to power a car, compared with petrol. The fuel tank thus occupies some of the space that was previously available for passengers and their luggage in the standard sedan. Engineers are examining how to make the fuel tank from lightweight carbon fibre, which may allow it to be reshaped to fit into the nooks and crannies of the car's chassis.

The refuelling process itself has also required careful attention. Liquid hydrogen has to be kept at –253°C and the area around the nozzle must be sealed to prevent the volatile fluid from evaporating during fuel delivery. When refuelling, drivers must complete an automatic docking procedure between nozzle and tank. Both pump and car then begin a digitally choreographed check for leaks. Only once this is complete does the flow of liquid hydrogen begin. It takes eight minutes to refuel with six litres of the fuel, enough to drive 200km (125 miles). Of course, the range of the car is greater than this because the driver can switch to petrol if the hydrogen tank is empty.

Using hydrogen may not prove to be the ultimate in environmentally friendly transport. That is because hydrogen does not exist naturally in its liquid form. Instead it has to be manufactured by splitting water into hydrogen and oxygen, a process that consumes energy. That energy itself must be produced in ways that do not emit greenhouse gases for hydrogen to be a truly green fuel.

BMW refuses to reveal how much the technology costs. It concedes that the sum is substantial but argues that prices would fall if more of the cars were made. For the moment the company plans to build just 100 vehicles. Nearly half will be sold to drivers in California and most of the rest will stay in Berlin. It is a small start, but BMW is betting that, if hydrogen does take off, its internal-combustion technology could be brought into production more quickly and cheaply than the fuel-cell technologies of its rivals.

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About sponsorship

Pandemic influenza

One step closer

Nov 16th 2006
From The Economist print edition

A mutation of the bird flu virus gives cause for concern

Get article background

FROM time to time the influenza viruses that make people and other animals ill mutate to become killers. Bird flu is already lethal in humans—half of the people who have caught it have died from it. What is saving the rest of humanity is the virus's seeming inability to spread easily from person to person. If it mutated in such a way that it was transmitted more easily, it could cause a pandemic that threatened the lives of millions of people.

One reason why scientists believed that bird flu had not yet become highly transmissible is that the deadly H5N1 form of the virus has had difficulty infecting the cells that line the nose and upper parts of the lungs. It simply failed to recognise what it should latch onto in humans. Instead it has been causing havoc with the cells deep in the lungs. This means that if a person infected with the virus coughs and sneezes, he would spray less of the stuff than if the upper part of the tract were infested.

The explanation for this lies in the shape of receptor molecules on cell surfaces, specifically, in how the sugar part of the receptor is bonded to its acid section. In the upper lung, the bond makes the receptor flat like a lilo; in the lower part it is bent like a chair. Until now the deadly bird-flu virus has been able to recognise the chair but not the lilo.

Shinya Yamada of the University of Tokyo and colleagues recently tested five samples of H5N1 taken from birds and 21 samples from people. As expected, none of the bird samples could bind to the lilo-shaped receptors. However, three of the human samples, taken from two Azerbaijanis and one Iraqi early this year, could bind to both kinds. This means that the virus has mutated to become more infectious in people. The work was reported in this week's *Nature*.

This discovery is cause for concern but not for panic. The deadly form of the virus must need to overcome further molecular hurdles to pass from person to person. Otherwise a pandemic would already be under way.

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About sponsorship

Wireless power

Cut the cables

Nov 16th 2006
From The Economist print edition

A practical way to recharge gadgets without plugging them in

ALTHOUGH the laws of physics cannot be altered at whim, scientists are adept at manipulating the world to sidestep this inconvenience. One such deft manoeuvre has just been proposed by physicists who have worked out how to recharge the batteries in mobile phones and laptop computers without using power cables.

Physicists have known how to transmit power wirelessly for almost two centuries. Michael Faraday discovered in 1831 that an electric current flowing in a wire induces a secondary current in a neighbouring wire. The principle is exploited in devices from electric motors to power transformers. The problem is that the energy is transmitted in all directions, which means that power is lost rapidly with distance. To exploit the effect, the wires have to be so close as to be almost touching. The alternative—pumping up the power—would zap people with rather too much electromagnetic radiation to be entirely safe.

Marin Soljacic and his colleagues at the Massachusetts Institute of Technology have devised a solution to this problem. They propose to transmit power using what are known as “non-radiative” fields and to distribute the electromagnetic energy so that it is carried by the magnetic rather than the electric part of the field. Because magnetic fields interact much less strongly than electric fields with most types of matter—including, most importantly, people—the transmission of power would be both more efficient and considerably safer. They reported their work to the industrial physics forum held by the American Institute of Physics in San Francisco this week.

One of the most promising layouts, according to the researchers, is to have a simple loop of wire connected to the mains and stuck to the ceiling. They showed that the electric field is confined near the ceiling, leaving only the magnetic field to transfer the energy to a smaller receiving loop a few metres away. This could be placed on, say, a laptop or mobile phone.

Non-radiative fields also have a second advantage. The energy can be gathered only by gadgets specially designed to “resonate” with the field. Most of the energy not picked up by a receiver can be reabsorbed by the emitter. The proposed system has an overall efficiency of 40% and Dr Soljacic hopes to boost this by tinkering with the materials and layout. The idea would be to install a source in each room of an office building, factory or home, giving wireless power throughout.

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About sponsorship

Innovation and entrepreneurship

No fear of flying

Nov 16th 2006
From The Economist print edition

How to create the next big thing? Four new books offer some ideas

Joe Wilson and the Creation of Xerox
By Charles D. Ellis

John Wiley; 396 pages; $27.95 and £18.99

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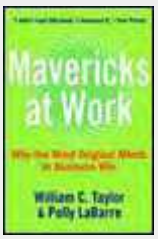
Amazon.com
Amazon.co.uk

Mavericks at Work: Why the Most Original Minds in Business Win
By William C. Taylor and Polly LaBarre



William Morrow; 336 pages; $26.95. HarperCollins; £12.99

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Outside Innovation: How Your Customers Will Co-Design Your Company's Future
By Patricia B. Seybold

HarperBusiness; 432 pages; $26.95

Buy it at
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The Entrepreneurial Imperative: How America's Economic Miracle Will Reshape the World (and Change Your Life)
By Carl J. Schramm

HarperBusiness; 208 pages; $24.95

Buy it at
Amazon.com
Amazon.co.uk

Getty Images

INNOVATION is the name of the game in business, now more than ever. Innovating successfully is fiendishly hard to do. It is not just that a good idea is hard to find. Turning a novel thought into a profitable product is arguably even harder. To make money, as the authors of four new books on the subject all agree, every great inventor needs a great entrepreneur.

Consider, for example, Chester Carlson's breakthrough in his flat in Queens, New York, where his smelly experiments provoked complaints from the neighbours. His invention of xerography would never have become the hugely profitable Xerox photocopying business were it not for what Charles Ellis calls the “extreme entrepreneurship” of Joe Wilson.

What Wilson added to Carlson's invention, says Mr Ellis in an inspiring biography, was “rigorous financial discipline, his focus on developing a new technology, and his remarkable capacity to keep his organisation committed to his vision for many long, lean years while going through the uncertainties of

deliberate transformational change.”

One reason Wilson could keep his company going through some exceedingly tough times was his fierce commitment to his workers, many of whom he retrained with the skills needed in the new photocopying business. This was part of a leadership style that emphasised listening and understanding, and was built on strong personal values.

Had he been doing business today, William Taylor and Polly LaBarre would surely have included Wilson among their “Mavericks at Work”, a pivotal work in the tradition of “In Search of Excellence” and “Good to Great” and featuring many of today's most interesting corporate rising stars. These are companies that blend the revolutionary zeal of the late 1990s dotcom era with an emphasis on values in a way that has set them apart from the ethical crisis gripping American business in the first years of this century.

The authors sum up their message thus: “Call it strategy as advocacy: who can redefine the terms of competition by challenging the norms and accepted practices of their business before disgruntled customers or reform-minded regulators do it for them?” They enthuse about companies such as Southwest Airlines, which set out to democratise air travel, and its advertising agency, GSD&M, which employs a “chief purposologist”; organic-food-obsessed Whole Foods Market; ING Direct, a bank that doesn't want to mire its customers in debt; and HBO, a cable-TV company that has broken with its industry colleagues by making complex, sophisticated dramas such as “Sex and the City” and “The Sopranos”.

Apart from their values and a willingness to challenge conventional thinking in their industry, what distinguishes the mavericks chosen by Mr Taylor and Ms LaBarre is their focus on hiring the best and motivating them well. The book concludes with five questions for would-be mavericks, each of which focuses on winning the increasingly fierce war for talent. Why should great people join your organisation? Do you know a great person when you see one? Can you find great people who aren't looking for you? Are you adept at teaching great people how your organisation works and wins? Does your organisation work as distinctively as it competes?

Instead of employees, Patricia Seybold focuses on the potential for using customers more in the innovation process. In “Outside Innovation”, she does a decent job of justifying her Martin Lukes-esque subtitle, “How Your Customers Will Co-Design Your Company's Future”. Her case studies cover a number of web-based companies and are written up with even more breathless enthusiasm than those of Mr Taylor and Ms LaBarre. These examples will be especially useful to anyone looking to innovate on the internet, particularly if open-source software is involved.

Ms Seybold reckons that most companies make two common mistakes about their customers. First, they think that customers can't envision what they don't know about—so innovation has to be driven by a company's in-house visionaries. Second, they believe that they already do a good job of listening to their customers. Citing companies ranging from Lego, which got customers to design its bestselling Mindstorms robot products, to “boutique streetwear retailer” Karmaloop, whose trendsetting customers are its sales force, she argues that companies urgently need to identify their most important customers and engage deeply with them about what they want.

Most of the companies these authors discuss are American. As Carl Schramm argues, more soberly, in “The Entrepreneurial Imperative”, no country has mastered innovation and entrepreneurship as effectively as America. Mr Schramm, who, as head of the Ewing Marion Kauffman Foundation in Kansas City pays for a lot of research into the subject, argues that America needs to do more to maintain its entrepreneurial edge. At the same time, it must promote the American model abroad as the centrepiece of its foreign policy—the global spread of wealth being the best recipe for national security. Mr Schramm argues strongly against protectionism: “The less secure we are economically, the more secure we are economically. The more new (good) ideas and new (innovative) companies surface to replace the old, the stronger our economy is.”

Yet for all the sage advice in these books, none of them really manages to unlock the mystery at the heart of entrepreneurship and innovation. What is the source of that crazy optimism that John Maynard Keynes called “animal spirits”? Reflecting years later on his success at Xerox, Wilson observed (in words that many an entrepreneur will echo) that “if we had fully foreseen the magnitude of the job”, the millions needed for research, the marketing complexities and manufacturing difficulties, “we probably would not have had the fortitude to go ahead. But we did.” Amen to that.

Joe Wilson and the Creation of Xerox.

By Charles D. Ellis.
John Wiley; 396 pages; $27.95 and £18.99

Mavericks at Work: Why the Most Original Minds in Business Win.
By William C. Taylor and Polly LaBarre.
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About sponsorship

Conrad Black's story

His and hers

Nov 16th 2006
From The Economist print edition

WHEN Conrad Black learned that Tom Bower was well advanced on a biography of himself and his wife, he fired off an e-mail that read: “Many people have contacted Barbara and me asking if they should talk with you...you have made it clear that you consider this whole matter a heart-warming story of two sleazy, spivvy, contemptible people, who enjoyed a fraudulent and unjust elevation; were exposed, and ground to powder in a just system; have been ostracised; and largely impoverished, and that I am on my way to the prison cell where I belong.”

That e-mail is a reasonably accurate summary of the book Mr Bower has written, but its ornate language and combativeness also give some clue why Lord Black (who was ennobled in 2001) makes such a vivid subject. While he combines the greed of Tyco's Dennis Kozlowski and the financial chicanery of Kenneth Lay and Bernie Ebbers, he is more interesting than any of them.

The key to understanding Lord Black, who is set to go on trial next March, is that for him business has never been more than the means to an end. It was a lesson he absorbed as a boy from his wealthy and cynical father, who taught him that greed, arrogance and unscrupulousness were the way of the world. At the same time, the precocious young Conrad learned from his passion for history that real heroes were permitted to flout rules designed by the mediocre to shackle them.

Outrageous Fortune: The Rise and Ruin of Conrad and Lady Black
By Tom Bower

HarperCollins; 448 pages; $26.95.
Published in Britain by HarperPress as "Conrad and Lady Black: Dancing on the Edge"; 448 pages; £20

Buy it at
Amazon.com
Amazon.co.uk

He was fortunate to find in David Radler the perfect foil to help him realise his ambitions. The driven, abstemious Mr Radler enjoyed sweating profits from small, neighbourhood newspapers in their native Canada, while Lord Black cut a dash as a budding media magnate with his eye for a deal, strong conservative views and flashy erudition.

Lord Black's greatest stroke of luck, however, was his purchase in 1986 of the ailing *Daily Telegraph*, Britain's biggest-selling quality newspaper, thanks to the help of a former editor of *The Economist*, Andrew Knight. When Rupert Murdoch dished the grasping print unions in the same year, Lord Black was able to follow in his slipstream, turning the loss-making *Telegraph* into a piggy bank both for his other businesses and for himself.

The *Telegraph* gave Lord Black everything he had dreamed of: riches, social status and influence. However, his marriage in 1992 to a journalist and fellow Canadian, Barbara Amiel, and his own outrageous sense of entitlement were more than the finances of either the *Telegraph* or the rest of his shaky empire could bear.

Mr Bower portrays Lady Black as every bit as much of a chancer as the husband over whom she still exerts a powerful hold, both sexual and intellectual. Marrying for the fourth time at the age of 51, the haughty, but always insecure, Ms Amiel believed she had married a man of unlimited means. Given free rein to an extravagance she admitted “has no bounds”, Lady Black encouraged her husband to befriend New York's super-rich elite. With their four houses in choice locations, their armies of butlers and the pair of private jets that stood ready to whisk them to the next celebrity party or shopping expedition, they were accepted at their own valuation.

But Lord Black, although wealthy by most standards, was no billionaire. There was only one way he could keep up appearances. Aided by Mr Radler, a tight-knit group of business cronies and a shamefully acquiescent audit committee, Lord Black's systematic long-term looting of the companies he controlled

became increasingly frenzied. Nemesis came eventually in the form of the activist New York investment company, Tweedy, Browne, which helped uncover Lord Black's use of “non-compete” fees to line his own pocket. Even now, Lord Black, confrontational to the last, sees himself as a victim of the “spite and envy” of others rather than of his own towering ego. This is a gripping cautionary tale that still awaits its denouement.

Outrageous Fortune: The Rise and Ruin of Conrad and Lady Black.
By Tom Bower.
HarperCollins; 448 pages; $26.95.
HarperPress; £20

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About sponsorship

Cold-war history

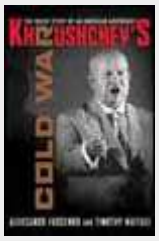
The power of peasant logic

Nov 16th 2006
From The Economist print edition

COMPARED with the hydra-headed fight against terror, the cold war seems to have been deceptively easy. Two main adversaries; each knew what the other could do and neither really wanted war. Or did they? Aleksandr Fursenko and Timothy Naftali's magnificent new book on Nikita Khrushchev contains unsettling insights into some of the most dangerous geopolitical crises of the time.

Khrushchev has been the subject of a number of books, including a recent Pulitzer prize-winning biography by William Taubman. Yet Messrs Fursenko and Naftali, respectively a member of the Russian Academy of Sciences and the new director of the Richard Nixon Presidential Library and Museum, have an advantage over previous authors. They obtained crucial secret documents from Moscow and, as the authors of an earlier influential study, "'One Hell of a Gamble': Khrushchev, Castro and Kennedy, 1958-1964", they know how to use these sources to get at what matters.

Khrushchev's Cold War: The Inside Story of an American Adversary
By Aleksandr Fursenko and Timothy Naftali



Norton; 670 pages; $35

Buy it at
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"Khrushchev's Cold War" unravels the tangled contradictions in his leadership of the Communist Party. The authors argue that he wanted to prevent a nuclear-arms race; a more feasible proposition in his day, when the Soviet Union had tens of nuclear warheads, than later when it had thousands. They go so far as to compare Khrushchev's interest in detente to that of Mikhail Gorbachev's—a daring assertion about the man who nuclearised Cuba.

How do they reconcile this claim with the shoe-pounding cold warrior of public record? Khrushchev used "peasant logic" to follow a convoluted route to his goals: "Scare your opponent enough, and he will give you what you want." But he undermined himself at every turn; his bullying was one reason why he was ousted in a 1964 coup. Whatever his intentions, the authors say, "it was Khrushchev's propensity to risk war that bedevilled US presidents" and made confrontation inevitable.

Western journalists also served as unlikely accomplices in fomenting cold-war terror. In one of the book's more startling sections, the authors detail how American columnists repeated and exaggerated false claims about the extent of Khrushchev's arsenal. President Dwight Eisenhower knew that the so-called "missile gap" tilted in America's favour. Nevertheless, this journalism created a public clamour for more missiles and was used by defence industry executives to press for purchases.

Crucially, it also led to some risky espionage. One of the U-2 surveillance flights that Eisenhower ordered ended in spectacular disaster on May Day 1960, when the Soviets shot down the aircraft and captured the pilot, Francis Gary Powers, alive. The reconstruction of Powers's KGB interrogation is gripping, while the analysis of what the crash cost the world, by leading Khrushchev to abandon planned talks with Eisenhower in Paris, makes for equally depressing reading.

Some passages in the book are too detailed for all but scholarly readers. These are the exception. The climactic showdown in Cuba, where many of the book's themes come together, is a good example of the authors' skill at bringing complex events to life. Khrushchev wanted a resolution to the contest over Berlin, yet he chose the most dangerous possible way to force one: via nuclear confrontation in Cuba.

This choice generated terrifying risks. Although Khrushchev might not have wanted to start a third world war, the authors offer a chilling reminder that "so much had to go right" for his plan to work. Any number of the small disobediences described here—from the Soviet commander who shot down an American plane without authorisation to Fidel Castro's frustration and increasingly irrational behaviour—

could have started a chain of events ending in thermonuclear war. Even if your intentions are to promote peace, once you start to scare your enemies with violence, it becomes very hard to predict how they or your allies will react—a lesson that is not limited to the cold war.

Khrushchev's Cold War: The Inside Story of an American Adversary.
By Aleksandr Fursenko and Timothy Naftali.
Norton; 670 pages; $35

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Short stories

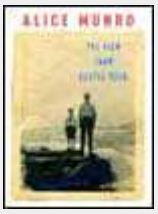
Voices from the past

Nov 16th 2006
From The Economist print edition

"I WAS lucky", writes Alice Munro, introducing her 11th collection of short stories, "in that every generation of our family seemed to produce somebody who went in for writing long, outspoken, sometimes outrageous letters, and detailed recollections." Ms Munro takes inspiration from this material to create the history of her ancestors, weaving the past she imagines for them into "the outline of a true narrative".

Ms Munro, born Alice Laidlaw in Ontario in 1931, is especially good at writing short fiction. "The View from Castle Rock" starts in the 18th century in the dour Scottish borders where her family scrapes a living from soil and sheep. Within a few generations the New World beckons and in 1818 the Laidlaws emigrate to Canada. This voyage sets the scene for the tales of the succeeding generations, which encompass a broad sweep of characters and events: a young boy glimpses his father's dream of a new life; a baby is lost and found; first love blossoms under an apple tree.

The View from Castle Rock: Stories
By Alice Munro



Knopf; 349 pages; $25.95.
Chatto and Windus; £15.99

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Mesmerising and cleverly interlinked, these stories are well balanced—neither overly inventive nor stolidly factual. Ms Munro's light touch and her sensitive embellishment of the truth result in a book that is illuminated by the patterns of life repeating themselves over the years: quiet domesticity is coupled with hope; taciturn fathers work without complaint; mothers are frugal and dutiful. A make-do and mend attitude runs throughout and the Laidlaw trait of knowing one's place is of the utmost importance.

In completing this collection—which the author has suggested may be her last—Ms Munro not only adds breadth to her family history but also explains the human need to establish where we come from. "It happens mostly in our old age", she writes, "when our personal futures close down and we cannot imagine—sometimes cannot believe in—the future of our children's children. We can't resist this rifling around in the past, sifting the untrustworthy evidence, linking stray names and questionable dates and anecdotes together, hanging on to threads, insisting on being joined to dead people and therefore to life."

The View from Castle Rock: Stories.
By Alice Munro.
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The Mediterranean

Salty tales

Nov 16th 2006
From The Economist print edition

JOHN JULIUS NORWICH is the author of more than a dozen books on Norman Sicily, the Sahara, Mount Athos and the Venetian and Byzantine empires. Yet even his immense knowledge is not enough to keep his latest chronicle—of 5,000 years of Mediterranean history—from appearing somewhat lopsided.

Lord Norwich's first test, he notes in his introduction to “The Middle Sea”, was to compensate for an ignorance of Spain. He records that he was fortuitously invited to dinner by “my dear friend” the Spanish ambassador to London and “a few weeks later there came an invitation for my wife and me to spend ten days in Spain.” It is hard to believe that was all the effort he made, for he acquits himself well, even in the convoluted diplomacy that ended in the war of the Spanish succession.

Lord Norwich's second task was to strike a balance over time. “The Middle Sea” reaches from ancient Egypt to the first world war. Like many long, chronological narratives, it becomes progressively more detailed, though it is debatable whether this is a good thing. Few people have changed the region as much as the Romans, yet their republic's five centuries get only a page more than the great siege of Gibraltar which began in 1779.

The Middle Sea: A History of the Mediterranean
By John Julius Norwich

Doubleday; 667 pages; $39.95.
Chatto and Windus; £25

Buy it at
Amazon.com
Amazon.co.uk

Lord Norwich's final, and arguably most important, challenge is the area that is most likely to engage modern readers: the intermittent, but frequently savage, conflict between Muslims and Christians. Impatient with the notion, echoed most recently and disastrously by Pope Benedict, that the Koran sanctions the spreading of Islam by the sword, Lord Norwich is no Islamophobe. He is hostile to the Crusades (“no more unedifying chapter” in the history of Christendom) and fulsome in his praise of that traditional Western schoolbook villain, Saladin.

Yet his account remains disappointingly focused from Christendom outwards. It is true that Muslims do appear in his book—usually in battle—but they rarely speak. Only two items in the 170-volume bibliography are by Arab scholars and only one is by a Turk. This is unabashedly history of the old school: Eurocentric (Octavian, the author declares without irony, was the “undisputed master of the known world”) and largely uninterested in what other economic, social and technological changes may have shaped events.

What fires Lord Norwich is recounting the doings of princes and preachers, warriors, courtiers and courtesans. And he does it with consummate skill. He spices his narrative liberally with entertaining anecdotes, deft portraits and brisk judgments. Aristotle, for example, is given short shrift as “one of the most reactionary intellectuals that ever lived”. Lord Norwich's control of his vast and complex subject matter is masterly. And the subject matter itself is as colourful as history can get. No sooner have readers bidden farewell to a short, fat, dissolute sultan, Selim the Sot, than they encounter the “piratical Uskoks, a heterogeneous, but exceedingly troublesome community”. Although few will resist the temptation to keep turning the pages, readers will close this monumental work exhilarated and informed, but with plenty of questions still unanswered.

The Middle Sea: A History of the Mediterranean.
By John Julius Norwich.
Doubleday; 667 pages; $39.95.
Chatto and Windus; £25

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New cinema

Women in love

Nov 16th 2006
From The Economist print edition

Two films explore the fallout of the war in Bosnia

Dogwoof Pictures

Survivor Sara

IN 2002 a bitter and tragicomic story of the Bosnian war won an Oscar for best foreign film. Made by a young Bosnian director, Danis Tanovic, “No Man's Land” eventually collected 42 awards around the world for its tale of three soldiers stuck between Serbian and Bosnian lines and then between the international press and a cynical UN peacekeeping command.

Two new films now take the Bosnian story further. Their directors are completely different, in background and vision, yet both their films follow eerily parallel paths—their central characters are Bosnian women with strikingly similar problems adjusting to single motherhood a decade after the end of the war.

The first is named “Grbavica”, after a part of Sarajevo which was held by Serbian forces during the war. The film will open in Britain next month where it will play under a different name: “Esma's Secret”. Esma is a middle-aged woman struggling to make ends meet. She works nights in a seedy bar, supplements her income by working as a seamstress and is trying to beg or borrow €200 ($260) so that her 12-year-old daughter, Sara, can go on a school trip.

Esma is played by Mirjana Karanovic, one of the former Yugoslavia's most famous and talented actresses. As the date of the school trip approaches Esma manages to find the cash but, in the process, her daughter discovers her terrible secret. Until now the child has always believed that her father died fighting the Serbs. In fact she was born after Esma was raped by Serbs during the war.

“Grbavica” has already won several awards, including the Golden Bear at the Berlin film festival. What is odd are the similarities between this film, by Jasmila Zbanic, a 31-year-old from Sarajevo, and “Breaking and Entering”, a new work by a veteran British director, Anthony Minghella. His story takes place around the massive redevelopment of the King's Cross area of London. In it Will Francis, an architect played by Jude Law, falls in love with Amira, a Bosnian refugee seamstress played by Juliette Binoche.

Will meets Amira after he has chased off her teenaged son Miro, who is part of a Bosnian gang that has robbed his offices. Amira sleeps with Will, initially because she wants to blackmail him into not reporting her son to the police. Just like Esma, she is prepared to do anything to protect a child whose troubles are a direct consequence of the damage that war has done to the family.

Mr Minghella's film has received sniffy, indeed somewhat snobbish reviews in Britain. These are unfair. His film is as gripping as “Grbavica”, more complex and will appeal to a wider audience. During the Bosnian war, it was not uncommon to see tightly packed cars struggling over icy unpaved roads. Bigger, more comfortable, foreign-made vehicles would make it to their destinations, but, entirely unexpectedly, small, Yugoslav-made Yugos, beeping ferociously, would zip past them on steep, mountainous tracks. These are both good films, but whereas “Grbavica” is a simple Yugo, Mr Minghella's film is a solid four-wheel-drive.

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About sponsorship

Markus Wolf

Nov 16th 2006
From The Economist print edition

Markus Wolf, East German spymaster, died on November 9th, aged 83

Getty Images

FASCINATING to his fans, odious to his enemies, Markus Wolf embodied the dilemmas and complexities of the cold war in Europe. Seen one way, he was something of a hero: not just a professional but also a patriot and an idealist. Even his ardent communism could be excused: had not his Jewish family found refuge from the Nazis in the Soviet Union? Revealed after the collapse of communism as cultivated, charming, an accomplished cook and, to some, a heart-throb, he was utterly unlike most Soviet-block spymasters—crumpled, podgy men with thick glasses and steel teeth.

There was a whiff of glamour in the way that Mr Wolf's spies outwitted their bumbling West German rivals. As head, for 34 years, of the foreign-intelligence arm of the Stasi, East Germany's Ministry of State Security, he planted agents and recruited informers all over West Germany. Some found their way into the very departments charged with defending democracy, others into the highest reaches of the state, even the chancellery. For those who believed the West to be shamefully materialist or unduly forgiving of the Nazi past, it was tempting to admire the guile of one who so often humiliated it.

“The man without a face”, he was called. His identity was so well concealed that his Western counterparts are supposed to have secured a photograph of him only in 1978. In fact, the CIA had identified him as early as 1959, from photographs taken when he had attended the Nuremberg war-crimes trials as a young radio reporter. Still, many thought he must be the model for the elusive Karla, the fictional Soviet spymaster who ran rings round his Western adversaries in the works of John le Carré, a British novelist steeped in the world of espionage. (Mr le Carré says he was not.)

Mr Wolf was, if anything, even more glamorous in defeat. Spurning American offers of a deal if he would tell all, he sought political asylum in Russia. When that was denied, he returned, and eloquently defended himself against charges of treason. “Victors' justice”, he called his trials; like Western spies, he was doing a dirty but necessary job, and his sins were “those of every other intelligence agency”.

The brutal reality

Yet there was nothing glamorous about the communist German state of 1949-89. Mr Wolf claimed that his subtle spycraft was a world away from the regrettable mistakes made by his Stasi colleagues in charge of internal repression and fostering terrorism abroad. After retiring—for mysterious reasons—from the Stasi in 1986, he published a book, “Troika”, which criticised Stalinism. Later he said he hoped that Mikhail Gorbachev's reforms would save a system nobly based on the “combination of socialism and freedom”.

He did admit that East Germany had proved a “sad reality”, but in truth it was far worse than that. The regime he served was a squalid dictatorship that jailed those who challenged it and shot those who tried

to escape. Its secret police exploited the smallest weakness of anyone who might be useful or threatening. Husbands were coerced into spying on their wives, parents on their children. Mr Wolf's spies played a full part in a huge security system modelled closely on the Soviet Union's, and using identical tricks.

Though cleared, on appeal, of his 1993 conviction for treason, Mr Wolf was given a two-year suspended sentence in 1997 for his part in the abduction and torture of a German woman who had worked for the Americans in West Berlin. Those may be the methods of the war on terror now, but they were not part of the West's arsenal then, in a struggle won mainly by the potency of ideas, not by force or fear.

Mr Wolf said his most successful tactic was the use of sex: his “Romeo” agents seduced and suborned the lonely spinster secretaries of West German officialdom. The practice worked brilliantly, if you were prepared to overlook the attendant tragedies, such as the death of the hapless Leonore Heinz, who killed herself when she found that her husband had married her not for love but to steal secrets from the foreign ministry, where she worked.

It was all clever stuff, but Mr Wolf's chief target was an easy one. Every East German had the right to West German citizenship. That made it simple to plant sleepers, such as Günter Guillaume, an agent sent to West Germany in 1956, who ended up as a senior aide to the chancellor, Willy Brandt. He produced startling news—not just of Brandt's womanising, but also, paradoxically, that the Social Democratic chancellor genuinely accepted the post-war division of Europe, including the sovereignty of East Germany.

That may have usefully calmed Soviet nerves. But the East Germans' carelessness was their star's downfall: they sent him a coded message congratulating him on the birth of his son. When that was cracked, he was caught. Brandt resigned, and his policy of detente with the East—*Ostpolitik*—stalled. Mr Wolf admitted that this had been a blunder. Like other people, he said, he sometimes felt remorse.

Maybe he did. Other communists, though, were much quicker to see not just the practical failures but the bankruptcy of the entire creed. Mr Wolf's mild penitence fell far short of convincing contrition.

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Overview

Nov 16th 2006
From The Economist print edition

The **euro area's** economy failed to maintain the swift pace it set earlier in the year. Industrial production fell by 1% in September. GDP growth slowed to 0.5% in the third quarter after a brisk 0.9% in the second. The economy still grew faster than America's in the third quarter, and is 2.6% bigger than a year earlier.

The euro-wide figure reflected some disappointing national results. **Germany's** economy slowed, growing by 0.6% in the third quarter, compared with 1.1% in the second. **France's** stopped growing altogether: GDP growth was zero in the third quarter. **Italy's** economy expanded by 0.3%, just half the rate it managed in the second quarter. Of the big euro members, only **Spain** impressed, growing by 0.9% in the third quarter and by 3.8% compared with a year earlier.

Japan's third quarter was as mediocre as Europe's. Its GDP grew by 0.5%, bolstered by exports and private investment, but held back by weak consumption. Inflation in producer prices slowed to 2.8% in the year to October, compared with 3.5% in the year to August and September.

In **America**, the risk of inflation remains the Federal Reserve's “dominant concern”, according to the minutes of its October rate-setting meeting, released this week. The slowdown in the housing market was no worse than the central bankers had expected, they said; and it had yet to weigh heavily on consumer spending. Moreover, core inflation remains “uncomfortably high” and the labour market appears quite tight, which could put upward pressure on wages.

The Fed will draw some comfort from **producer prices**, which fell by 1.6% in October, the biggest drop for five years. Even ignoring the tumbling cost of energy (-5%) and food (-0.8%), prices fell by 0.9%. At the other end of the production chain, the value of retail sales slipped by 0.2% in October, after a fall of 0.8% the month before.

In **Britain**, the unemployment rate rose to 5.6% in the third quarter, compared with 4.8% a year earlier. Average earnings, including bonuses, grew by 3.9% in the year to September, slower than the 4.2% increase in the year to August.

House prices in **Australia** rose by 9.5% in the year to the third quarter, based on figures from eight cities. In Perth, in western Australia, they rose by almost 46% over the year.

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Output, demand and jobs

Nov 16th 2006
From The Economist print edition

% change on year ago

	GDP			The Economist poll GDP forecasts		Industrial production		Retail sales (volume)		Unemployment % rate		
	latest		qtr*	2006	2007	latest		latest		latest		year ago
Australia	+ 1.9	Q2	+ 1.3	+ 2.7	+ 3.2	– 3.0	Q2	+ 3.2	Q3	4.6	Oct	5.2
Austria	+ 3.3	Q3	+ 3.6	+ 2.8	+ 2.1	+ 9.1	Aug	+ 1.8	Aug	4.7	Oct	5.2
Belgium	+ 3.1	Q3	+ 2.4	+ 2.7	+ 1.9	+10.7	Aug	nil	Aug	13.0	Sep†	13.5
Britain	+ 2.8	Q3	+ 2.8	+ 2.6	+ 2.4	+ 0.4	Sep	+ 3.2	Sep	5.6	Sep‡	4.7
Canada	+ 2.9	Q2	+ 2.0	+ 2.8	+ 2.5	– 0.4	Aug	+ 3.7	Jul	6.2	Oct	6.6
Denmark	+ 2.8	Q2	+ 6.5	+ 3.1	+ 2.3	– 0.7	Sep	+ 3.3	Sep	4.2	Sep	5.5
France	+ 1.9	Q3	nil	+ 2.3	+ 2.0	– 0.7	Sep	+ 1.7	Sep	8.8	Sep	9.8
Germany	+ 2.8	Q3	+ 2.6	+ 2.4	+ 1.4	+ 6.3	Sep	– 1.2	Sep	10.4	Oct§	11.6
Italy	+ 1.7	Q3	+ 1.3	+ 1.7	+ 1.2	+ 1.3	Sep	+ 0.1	Aug	7.0	Q2	7.8
Japan	+ 2.7	Q3	+ 2.0	+ 2.7	+ 2.1	+ 5.2	Sep	+ 0.3	Aug	4.2	Sep	4.3
Netherlands	+ 2.6	Q3	+ 2.6	+ 2.7	+ 2.2	+ 1.2	Sep	+ 3.5	Jul	5.5	Oct††	6.5
Spain	+ 3.8	Q3	+ 3.6	+ 3.5	+ 2.8	+ 0.9	Sep	+ 3.8	Sep	7.8	Sep	8.6
Sweden	+ 5.1	Q2	+ 5.4	+ 4.4	+ 3.1	+ 6.0	Sep	+ 8.7	Sep	4.6	Oct†	5.6
Switzerland	+ 3.2	Q2	+ 3.0	+ 2.9	+ 2.1	+ 4.3	Q2	+ 4.5	Aug	3.1	Oct†	3.7
United States	+ 2.9	Q3	+ 1.6	+ 3.3	+ 2.3	+ 5.6	Sep	+ 6.1	Sep	4.4	Oct	4.9
Euro area	+ 2.6	Q3	+ 2.0	+ 2.6	+ 1.9	+ 3.3	Sep	+ 1.4	Sep	7.8	Sep	8.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 6.6	Q2	+ 7.6	na	na	+ 6.8	Sep	+ 7.1	Sep	7.9	Sep	8.3
Greece	+ 4.3	Q3	na	na	na	– 2.6	Sep	+10.1	Aug	8.8	Q2	9.6
Iceland	+ 2.8	Q2	na	na	na	na		na		1.2	Aug†	1.8
Ireland	+ 5.0	Q2	+ 3.6	na	na	+ 6.0	Sep	+ 5.5	Aug	4.4	Oct	4.4
Luxembourg	+ 5.4	Q2	na	na	na	– 1.4	Jul	+ 1.7	Sep	4.4	Sep	4.3
New Zealand	+ 1.6	Q2	+ 1.7	na	na	+ 0.5	Q2	+ 1.0	Q3	3.8	Q3	3.7
Norway	– 0.5	Q2	+ 1.9	na	na	– 4.7	Sep	+ 8.1	Sep	3.3	Sep**	4.8
Portugal	+ 0.9	Q2	+ 3.8	na	na	+ 1.6	Sep	+ 2.1	Sep	7.3	Q2†	7.2

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡Jul-Sep; claimant count rate 3.0% in Sep. §EU harmonised rate 8.7% in Sep. ††Aug-Oct. **Jul-Sep

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Prices and wages

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From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2006	2007	latest		year ago	latest		year ago
Australia	+ 3.9	Q3	+ 3.0	+ 3.4	+ 2.7	+ 7.9	Q3	+ 6.2	+ 4.7	Q2	+ 5.8
Austria	+ 1.4	Sep	+ 2.4	+ 1.7	+ 1.7	+ 2.4	Oct	+ 1.3	+ 2.7	Sep	+ 2.3
Belgium	+ 1.2	Oct	+ 2.5	+ 2.2	+ 2.0	+ 6.1	Sep	+ 1.4	+ 2.1	Jul	+ 2.5
Britain	+ 2.4	Oct*	+ 2.3	+ 2.3	+ 2.2	+ 1.7	Oct	+ 2.6	+ 3.9	Sep†	+ 4.1
Canada	+ 0.7	Sep	+ 3.4	+ 2.2	+ 2.1	+ 1.3	Sep	+ 0.9	+ 1.1	Aug	+ 1.8
Denmark	+ 1.5	Oct	+ 2.0	+ 2.0	+ 2.0	+ 2.6	Sep	+ 5.3	+ 3.2	Q2	+ 2.9
France	+ 1.1	Oct	+ 1.8	+ 1.8	+ 1.5	+ 2.7	Sep	+ 3.3	+ 3.1	Q2	+ 3.0
Germany	+ 1.1	Oct	+ 2.3	+ 1.7	+ 2.3	+ 2.9	Oct	+ 2.7	+ 0.8	Aug	+ 0.9
Italy	+ 1.8	Oct	+ 2.2	+ 2.2	+ 1.9	+ 5.4	Sep	+ 3.8	+ 3.0	Sep	+ 3.1
Japan	+ 0.6	Sep	– 0.3	+ 0.3	+ 0.5	+ 2.8	Oct	+ 2.1	+ 1.0	Sep	– 0.1
Netherlands	+ 0.9	Oct	+ 1.6	+ 1.6	+ 1.7	+ 2.8	Sep	+ 5.3	+ 1.9	Oct	+ 0.9
Spain	+ 2.5	Oct	+ 3.5	+ 3.5	+ 2.8	+ 4.2	Sep	+ 5.4	+ 3.1	Q2	+ 3.4
Sweden	+ 1.3	Oct	+ 0.5	+ 1.4	+ 1.8	+ 3.6	Sep	+ 4.2	+ 3.1	Aug	+ 3.3
Switzerland	+ 0.3	Oct	+ 1.3	+ 1.2	+ 1.2	+ 2.5	Sep	+ 1.5	+ 1.0	2005	+ 0.9
United States	+ 2.1	Sep	+ 4.7	+ 3.4	+ 2.3	– 1.6	Oct	+ 5.9	+ 3.9	Oct	+ 3.1
Euro area	+ 1.6	Oct	+ 2.5	+ 2.2	+ 2.1	+ 4.6	Sep	+ 4.4	+ 2.4	Q2	+ 2.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.5	Sep	+ 1.2	na	na	+ 5.9	Sep	+ 3.8	+ 2.9	Q2	+ 3.7
Greece	+ 2.8	Oct	+ 3.8	na	na	+ 3.6	Sep	+ 6.7	na		na
Iceland	+ 7.3	Nov	+ 4.2	na	na	+11.9	Oct	+ 4.2	+10.8	Sep	+ 6.9
Ireland	+ 3.9	Oct	+ 3.0	na	na	+ 0.1	Sep	– 0.2	+ 4.1	Q2	+ 3.5
Luxembourg	+ 1.5	Oct	+ 3.1	na	na	+ 9.3	Aug	+ 5.4	+ 0.4	Aug	+ 1.1
New Zealand	+ 3.5	Q3	+ 3.4	na	na	+ 6.9	Q3	+ 6.1	+ 3.2	Q3	+ 3.1
Norway	+ 2.7	Oct	+ 1.8	na	na	+ 5.9	Oct	+10.1	+ 3.6	Q2	+ 3.8
Portugal	+ 3.0	Sep	+ 2.8	na	na	+ 4.3	Sep	+ 4.5	+ 0.8	Sep	– 1.1

*RPI inflation rate 3.7% in Oct. †Jul-Sep.

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Tax burdens

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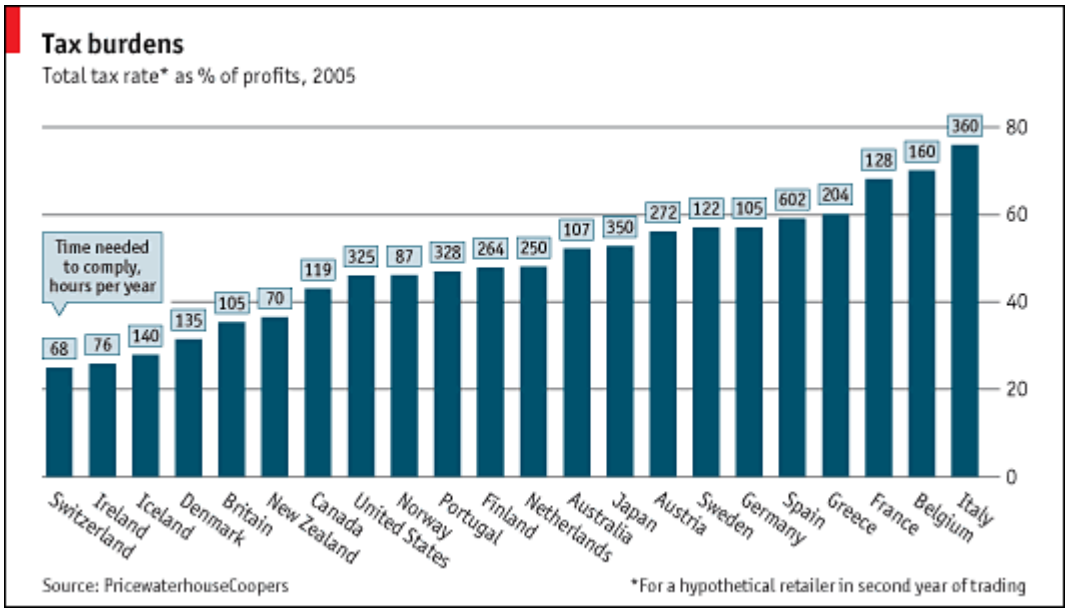
Corporation taxes are only part of the total levy on businesses. PricewaterhouseCoopers, a big accounting firm, has calculated the "total tax burden" on companies, which includes the other taxes they must pay, such as social-security contributions. For a hypothetical small firm, PwC has also worked out the time needed to prepare and file tax payments. This is only 68 hours in Switzerland but more than 600 hours in Spain.



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Money and interest rates

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From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Nov 15th 2006)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+10.6	+11.2	Sep	6.37	5.63	5.98	5.56	5.44	6.66
Britain	+ 5.1	+14.5	Sep	5.20	4.58	4.94	4.55	4.16	5.54
Canada	+ 8.8	+ 7.6	Sep	4.19	3.23	3.98	4.00	4.09	5.21
Denmark	+ 8.4	+ 8.0	Sep	3.62	2.35	3.75	3.70	3.39	5.09
Japan	+ 0.7	+ 0.7	Oct	0.36	0.02	0.81	1.70	1.51	1.94
Sweden	- 0.4	+14.4	Sep	2.78	1.50	3.46	3.46	3.31	3.79
Switzerland	- 2.4	+ 1.6	Sep	1.90	0.95	2.17	2.17	2.17	2.53
United States	- 1.1	+ 4.4	Sep	5.25	4.21	4.82	4.82	4.50	5.49
Euro area†	+ 7.1	+ 8.5	Sep	3.60	2.35	3.73	3.73	3.39	3.83

*Narrow: M1 except Britain notes and coin and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.69%, Japan No. 283 1.69%. Central bank rates: US fed funds 5.25%, ECB refinancing 3.25%, BOJ overnight call 0.25%, BOE repo 5.0%. Sources: Bank of Canada, Commerzbank, Danske Bank, Global Insight, JPMorgan Chase, Lehman Brothers, Stockholmsbörsen, UBS, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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About sponsorship

The Economist commodity price index

Nov 16th 2006
From The Economist print edition

2000=100

	Nov 7th	Nov 14th*	% change on one month	% change on one year
Dollar index				
All items	186.7	182.3	– 1.3	+ 33.6
Food	151.0	150.9	+ 2.4	+ 22.7
Industrials				
All	232.8	222.9	– 4.3	+ 45.0
Nfa†	137.1	133.9	– 3.8	+ 0.9
Metals	284.9	271.4	– 4.4	+ 64.2
Sterling index				
All items	148.3	145.9	– 2.6	+ 22.3
Euro index				
All items	134.8	131.6	– 3.4	+ 21.8
Yen index				
All items	203.4	199.0	– 2.1	+ 32.0
Gold				
$ per oz	626.00	620.90	+ 5.7	+ 32.7
West Texas Intermediate				
$ per barrel	59.00	58.34	– 0.9	+ 1.1

*Provisional. †Non-food agriculturals.

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Stockmarkets

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From The Economist print edition

Market indices

	Nov 15th	2006 high	2006 low	% change on one week	% change on record high	% change on Dec 30th 2005 in local currency	% change on Dec 30th 2005 in $ terms
Australia (All Ordinaries)	5,399.1	5,456.7	4,708.8	- 0.5	- 1.1	+14.7	+19.6
Austria (ATX)	4,109.0	4,344.4	3,324.1	- 0.4	- 5.4	+12.1	+21.7
Belgium (Bel 20)	4,273.8	4,273.8	3,445.1	+ 1.3	nil	+20.4	+30.7
Britain (FTSE 100)	6,229.8	6,244.0	5,506.8	- 0.1	- 10.1	+10.9	+21.9
Canada (Toronto Composite)	12,425.4	12,487.3	10,904.3	+ 0.4	- 0.5	+10.2	+12.8
Denmark (OMXCB)	403.3	405.7	325.0	- 0.6	- 0.6	+ 9.6	+19.0
France (SBF 250)	3,900.4	3,900.4	3,244.2	+ 1.4	- 11.2	+18.2	+28.3
France (CAC 40)	5,511.5	5,511.5	4,615.4	+ 1.4	- 20.4	+16.9	+26.9
Germany (DAX)*	6,430.9	6,430.9	5,292.1	+ 1.3	- 20.3	+18.9	+29.1
Italy (S&P/MIB)	40,813.0	40,813.0	34,850.0	+ 1.0	- 18.6	+14.3	+24.1
Japan (Nikkei 225)	16,243.5	17,563.4	14,218.6	+ 0.2	- 58.3	+ 0.8	+ 0.8
Japan (Topix)	1,592.0	1,783.7	1,458.3	- 0.3	- 44.8	- 3.5	- 3.6
Netherlands (AEX)	497.0	497.5	412.9	- 0.1	- 29.2	+13.8	+23.5
Spain (Madrid SE)	1,548.3	1,548.3	1,156.8	+ 1.0	nil	+33.9	+45.4
Sweden (Affarsvarlden Gen)	350.5	350.5	275.2	+ 1.0	- 12.4	+19.4	+34.2
Switzerland (Swiss Market)	8,791.2	8,835.6	7,154.9	+ 0.2	- 0.5	+15.9	+22.5
United States (DJIA)	12,251.7	12,251.7	10,667.4	+ 0.6	nil	+14.3	+14.3
United States (S&P 500)	1,396.6	1,396.6	1,223.7	+ 0.8	- 8.6	+11.9	+11.9
United States (NASDAQ Comp)	2,442.8	2,442.8	2,020.4	+ 2.4	- 51.6	+10.8	+10.8
Europe (FTSEurofirst 300)†	1,470.8	1,470.9	1,238.7	+ 0.1	- 13.7	+15.3	+25.2
Euro area (FTSE Euro 100)†	1,269.4	1,269.4	1,050.0	+ 0.9	- 18.1	+16.6	+26.6
World (MSCI)‡	1,440.9	1,440.9	1,243.9	+ 0.5	- 0.5	+14.6	+14.6
World bond market (Citigroup)††	652.0	655.5	612.1	+ 0.2	- 2.2	+ 5.1	+ 5.1

*Total return index. †In euro terms. ‡Morgan Stanley Capital International index includes individual markets listed above plus eight others, in $ terms. ††Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Nov 16th 2006
From The Economist print edition

	Trade balance*, $bn latest 12 months	Current-account balance $bn latest 12 mths	Current-account balance The Economist poll % of GDP, forecast 2006	Current-account balance The Economist poll % of GDP, forecast 2007	Exchange rate trade-weighted† 2000=100 Nov 15th	Exchange rate trade-weighted† 2000=100 year ago	Currency units per $ Nov 15th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2006‡
Australia	− 9.6 Sep	− 41.0 Q2	− 5.6	− 5.2	119.1	117.2	1.31	1.37	2.47	1.67	1.11	+ 0.9
Austria	− 1.8 Aug	+ 9.2 Q2	+ 1.1	+ 1.1	105.8§	105.1	0.78	0.86	1.47	–	0.66	− 1.9
Belgium	+ 15.9 Aug	+ 6.5 Jun	+ 1.8	+ 1.9	107.6§	106.8	0.78	0.86	1.47	–	0.66	− 0.4
Britain	−144.2 Sep	− 64.4 Q2	− 2.6	− 2.8	101.6	98.3	0.53	0.58	–	0.68	0.45	− 3.4
Canada	+ 53.7 Sep	+ 28.6 Q2	+ 1.4	+ 0.9	126.3	122.3	1.14	1.19	2.15	1.46	0.97	+ 2.2
Denmark	+ 7.7 Sep	+ 7.6 Sep	+ 2.0	+ 1.9	106.5	105.9	5.82	6.39	11.0	7.46	4.93	+ 3.3
France	− 34.9 Sep	− 39.8 Aug	− 1.5	− 1.2	108.5§	107.5	0.78	0.86	1.47	–	0.66	− 2.9
Germany	+187.4 Sep	+107.5 Sep	+ 3.6	+ 3.7	110.2§	108.9	0.78	0.86	1.47	–	0.66	− 3.1
Italy	− 25.5 Aug	− 34.6 Aug	− 1.8	− 1.7	108.1§	107.1	0.78	0.86	1.47	–	0.66	− 4.2
Japan	+ 78.4 Sep	+168.1 Sep	+ 3.6	+ 3.6	79.2	81.6	118	119	223	151	–	− 5.2
Netherlands	+ 38.3 Sep	+ 63.2 Q3	+ 6.3	+ 5.7	108.5§	107.5	0.78	0.86	1.47	–	0.66	− 0.5
Spain	−106.4 Aug	− 98.4 Aug	− 8.1	− 7.8	105.9§	105.3	0.78	0.86	1.47	–	0.66	+ 1.1
Sweden	+ 19.1 Sep	+ 24.1 Q2	+ 6.4	+ 5.9	100.3	92.8	7.08	8.25	13.4	9.07	6.00	+ 1.7
Switzerland	+ 8.8 Sep	+ 55.3 Q2	+13.5	+12.9	104.5	106.5	1.25	1.33	2.35	1.60	1.06	− 0.2
United States	−849.5 Sep	−838.1 Q2	− 6.6	− 6.5	84.1	88.9	–	–	1.89	1.28	0.85	− 3.6
Euro area	− 24.6 Aug	− 44.1 Aug	− 0.4	− 0.1	119.3	114.9	0.78	0.86	1.47	–	0.66	− 2.3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 11.1 Aug	+ 11.8 Sep	na	na	109.2§	108.3	0.78	0.86	1.47	–	0.66	+ 2.2
Greece	− 40.5 Aug	− 26.1 Aug	na	na	105.0§	104.3	0.78	0.86	1.47	–	0.66	− 3.0
Iceland	− 1.9 Sep	− 3.4 Q2	na	na	85.6**	100.9	70.3	62.0	133	90.0	59.5	+ 2.0
Ireland	+ 37.4 Aug	− 6.0 Q2	na	na	113.9§	112.4	0.78	0.86	1.47	–	0.66	− 0.3
Luxembourg	− 5.4 Aug	+ 4.2 Q2	na	na	107.6§	106.8	0.78	0.86	1.47	–	0.66	− 1.7
New Zealand	− 4.1 Sep	− 10.2 Q2	na	na	129.4	139.6	1.51	1.46	2.85	1.93	1.28	+ 4.6
Norway	+ 57.7 Oct	+ 56.5 Q2	na	na	106.4	112.1	6.44	6.69	12.2	8.25	5.45	+ 18.5
Portugal	− 22.9 Aug	− 16.4 Aug	na	na	105.9**	105.0	0.78	0.86	1.47	–	0.66	− 5.0

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, August average. ‡OECD forecast. **IMF, June average.

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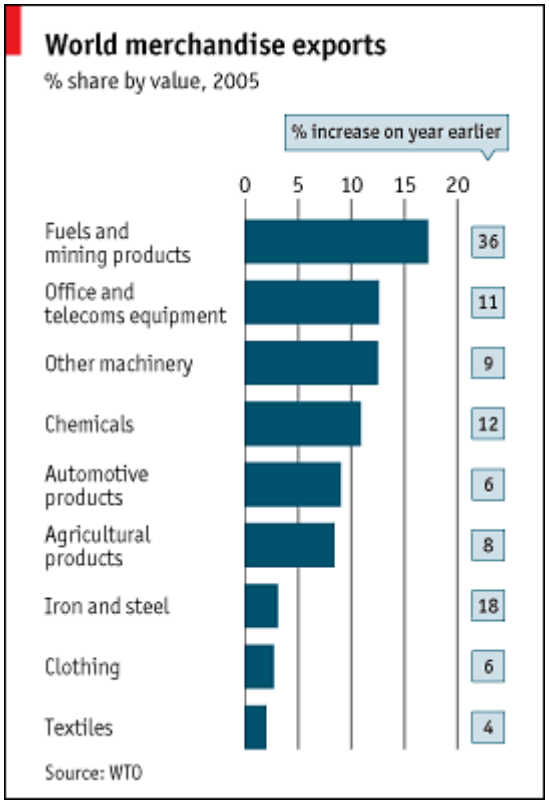
About sponsorship

World merchandise exports

Nov 16th 2006
From The Economist print edition



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Overview

Nov 16th 2006
From The Economist print edition

In **China** industrial-production growth slackened to 14.7% in the year to October. Consumer prices rose by 1.4% over the same period, down from 1.5% in September.

Industrial-output growth picked up in **India** to 11.4% in the year to September. Over the same period it eased to 5.0% in **Mexico**; and it also fell back in **South Africa** to 1.9%. But in **Venezuela** it accelerated to 12.7% in the year to August.

Inflation slowed in **Brazil** to 3.3% in the year to October, compared with 3.7% in September. But in **Mexico**, it increased to 4.3% in October from 4.1% in September.

Russia ran a 12-month trade surplus of $142.7 billion in September. Over the same period **Peru** had a surplus of $8.0 billion.

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The Economist poll of forecasters

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From The Economist print edition

Every three months *The Economist* polls a group of forecasters and averages their predictions for economic growth and current-account balances in 25 countries. Since August the panel has become more optimistic about GDP growth this year in 14 countries, especially Singapore and Venezuela, and more pessimistic about the prospects for ten, notably Brazil, Chile and South Korea. For 2007, the forecasts for Argentina, Peru and Venezuela have been marked up the most.

November

	Real GDP % change		Current account % of GDP	
	2006	2007	2006	2007
China	10.5	9.4	7.6	6.7
Hong Kong	6.0	5.0	10.0	9.3
India	8.3	7.4	-2.2	-2.2
Indonesia	5.3	5.8	1.8	1.4
Malaysia	5.5	5.2	13.1	11.1
Philippines	5.5	5.3	3.6	3.1
Singapore	7.7	5.0	27.6	25.2
South Korea	4.9	4.2	0.4	nil
Taiwan	4.1	3.9	5.4	5.0
Thailand	4.3	4.3	0.8	nil
Argentina	7.9	6.3	2.5	1.6
Brazil	3.0	3.3	1.3	0.3
Chile	4.7	5.3	3.6	2.2
Colombia	5.1	4.5	-1.8	-2.1
Mexico	4.4	3.2	-0.4	-1.1
Peru	6.0	5.4	1.2	0.7
Venezuela	7.8	5.5	14.9	10.1
Egypt	5.5	5.4	1.8	1.1
Israel	4.2	4.2	2.2	1.5
South Africa	4.3	4.2	-5.9	-4.9
Czech Republic	6.0	4.8	-3.2	-2.7
Hungary	3.7	2.4	-7.7	-5.9
Poland	5.3	4.7	-1.7	-2.2
Russia	6.7	6.5	11.0	7.3
Turkey	5.2	4.0	-7.9	-6.6

Sources: ABN AMRO; Deutsche Bank; Economist Intelligence Unit; Goldman Sachs; HSBC; ING Financial Markets; JPMorgan Chase; Merrill Lynch; UBS.

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Economy

Nov 16th 2006
From The Economist print edition

	% change on year ago						Latest 12 months, $bn		Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+10.4	Q3	+14.7	Oct	+ 1.4	Oct	+155.2	Oct	+160.8	2005	987.9	Sep
Hong Kong	+ 5.2	Q2	+ 5.3	Q2	+ 2.1	Sep	−15.9	Sep	+18.6	Q2	131.2	Oct
India	+ 8.9	Q2	+11.4	Sep	+ 6.8	Sep	−42.0	Sep	−13.2	Q2	160.2	Oct
Indonesia	+ 5.5	Q3	+ 6.2	Aug	+ 6.3	Oct	+37.0	Sep	+ 4.1	Q2	38.4	Oct
Malaysia	+ 5.9	Q2	+ 3.6	Sep	+ 3.3	Sep	+28.6	Sep	+20.0	Q2	79.3	Sep
Pakistan	+ 6.6	2006†	+ 7.5	Aug§	+ 8.1	Oct	−12.8	Sep	− 5.0	Q2	10.9	Sep
Philippines	+ 5.5	Q2	− 7.0	Aug	+ 5.4	Oct	− 4.1	Aug	+ 4.3	Jun	19.4	Oct
Singapore	+ 7.1	Q3	+ 7.6	Sep	+ 0.4	Sep	+33.7	Sep	+38.3	Q2	131.9	Oct
South Korea	+ 4.6	Q3	+16.3	Sep	+ 2.1	Oct	+14.9	Oct	+ 6.9	Sep	229.5	Oct
Taiwan	+ 4.6	Q2	+ 2.1	Sep	− 1.2	Oct	+21.7	Oct	+20.6	Q2	261.8	Oct
Thailand	+ 4.9	Q2	+ 5.0	Sep	+ 2.8	Oct	− 1.2	Sep	+ 3.7	Sep	60.0	Sep
Argentina	+ 7.9	Q2	+ 6.6	Sep	+10.5	Oct	+11.5	Sep	+ 7.4	Q2	27.0	Sep
Brazil	+ 1.2	Q2	+ 1.3	Sep	+ 3.3	Oct	+46.5	Oct	+13.3	Sep	70.8	Sep
Chile	+ 4.5	Q2	− 2.6	Sep	+ 2.1	Oct	+21.2	Oct	+ 2.2	Q2	17.5	Oct
Colombia	+ 6.0	Q2	+12.5	Aug	+ 4.2	Oct	+ 0.7	Jul	− 2.2	Q2	15.0	Oct
Mexico	+ 4.7	Q2	+ 5.0	Sep	+ 4.3	Oct	− 5.3	Sep	− 0.6	Q2	82.4	Sep
Peru	+ 9.2	Aug	+ 9.9	Aug	+ 1.9	Oct	+ 8.0	Sep	+ 1.3	Q2	14.5	Sep
Venezuela	+ 9.2	Q2	+12.7	Aug	+ 8.7	Oct	+37.2	Q2	+29.5	Q2	27.6	Aug
Egypt	+ 5.9	Q1	+ 4.0	2005†	+ 9.6	Sep	−11.2	Q1	+ 2.1	Q1	24.0	Oct
Israel	+ 4.8	Q3	+ 8.1	Aug	+ 1.3	Sep	− 7.6	Oct	+ 5.8	Q2	27.5	Oct
Saudi Arabia	+ 6.6	2005‡	na		+ 2.2	Aug	+125.6	2005	+90.0	2005	25.4	Aug
South Africa	+ 3.6	Q2	+ 1.9	Sep	+ 5.3	Sep	− 7.6	Sep	−13.3	Q2	22.1	Oct
Czech Republic	+ 6.2	Q2	+ 5.8	Sep	+ 1.3	Oct	+ 1.8	Sep	− 3.8	Q2	30.5	Oct
Hungary	+ 3.6	Q3	+11.8	Sep	+ 6.3	Oct	− 3.1	Sep	− 7.6	Q2	20.7	Oct
Poland	+ 5.5	Q2	+11.7	Sep	+ 1.2	Oct	− 3.6	Aug	− 6.6	Aug	46.7	Sep
Russia	+ 7.4	Q2	+ 4.1	Sep	+ 9.2	Oct	+142.7	Sep	+101.4	Q3	265.0	Oct
Turkey	+ 7.5	Q2	+ 4.0	Sep	+10.0	Oct	−51.4	Sep	−32.6	Sep	58.5	Sep
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+12.0	Q2	+ 1.8	Sep	+ 3.7	Oct	− 3.0	Aug	− 2.0	Sep	2.3	Aug
Latvia	+10.9	Q2	+ 2.5	Sep	+ 5.6	Oct	− 4.4	Sep	− 3.4	Sep	3.9	Aug
Lithuania	+ 6.3	Q3	na		+ 3.6	Oct	− 4.6	Sep	− 2.8	Sep	4.1	Aug
Slovakia	+ 9.8	Q3	+ 9.7	Sep	+ 3.7	Oct	− 3.1	Aug	− 5.0	Jul	12.5	Aug
Slovenia	+ 4.9	Q2	+ 7.5	Sep	+ 1.5	Oct	− 1.8	Sep	− 0.7	Aug	7.7	Jul

*Excluding gold, except Singapore and China; IMF definition. †Year ending June. ‡Economist Intelligence Unit estimate. §New series.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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Financial markets

Nov 16th 2006
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Nov 15th		Dec 30th 2005	
	Nov 15th	year ago	Nov 15th	% a year		one week	in local currency	in $ terms
China	7.87	8.08	14.9	3.00	2,021.1	+3.0	+ 65.5	+ 69.8
Hong Kong	7.79	7.76	14.7	3.93	19,093.0	+1.5	+ 28.3	+ 27.8
India	45.3	45.7	85.6	6.63	13,469.4	+3.0	+ 43.3	+ 42.3
Indonesia	9,183	10,010	17,332	10.18	1,670.1	+1.5	+ 43.6	+ 53.9
Malaysia	3.65	3.78	6.88	3.75	1,028.4	+2.1	+ 14.3	+ 18.4
Pakistan	60.8	59.9	115	10.33	10,811.9	-1.5	+ 13.1	+ 11.3
Philippines	50.1	54.7	94.6	6.13	2,791.5	+1.3	+ 33.2	+ 41.0
Singapore	1.56	1.70	2.94	3.44	2,777.6	+1.5	+ 18.3	+ 26.1
South Korea	941	1,038	1,777	4.61	1,412.5	+2.4	+ 2.4	+ 10.0
Taiwan	32.8	33.6	61.9	1.84	7,236.9	+0.8	+ 10.5	+ 10.6
Thailand	36.6	41.2	69.0	5.25	734.1	-0.7	+ 2.8	+ 15.4
Argentina	3.07	2.95	5.79	10.44	1,918.1	+4.2	+ 24.3	+ 22.6
Brazil	2.15	2.20	4.06	13.67	41,290.0	-0.1	+ 23.4	+ 34.1
Chile	529	525	998	5.16	11,440.6	+1.2	+ 24.3	+ 20.4
Colombia	2,273	2,279	4,290	6.70	10,534.0	-0.6	+ 10.7	+ 11.4
Mexico	10.9	10.6	20.5	7.04	24,315.6	+1.6	+ 36.6	+ 33.7
Peru	3.23	3.36	6.10	4.45	11,184.4	+0.5	+132.9	+147.4
Venezuela	3,029§	2,726§	5,717	10.24	39,074.8	+3.9	+ 91.6	+ 63.6
Egypt	5.72	5.76	10.80	9.49	57,601.3	+1.3	+ 4.0	+ 4.4
Israel	4.31	4.73	8.13	5.26	927.4	+0.8	+ 12.0	+ 19.8
Saudi Arabia	3.75	3.75	7.08	5.18	8,400.9	-0.3	- 49.7	- 49.7
South Africa	7.28	6.76	13.7	8.85	23,659.4	-1.2	+ 30.7	+ 14.0
Czech Republic	21.9	25.1	41.4	2.64	1,547.2	-0.5	+ 5.0	+ 18.0
Hungary	201	215	379	8.20	23,206.0	+0.6	+ 11.6	+ 18.9
Poland	2.97	3.41	5.60	4.19	48,099.0	-2.7	+ 35.1	+ 48.3
Russia	26.7	28.9	50.3	11.00	1,705.8‡	+2.6	+ 40.6	+ 51.5
Turkey	1.45	1.36	2.73	19.39	39,654.1	-0.2	- 0.3	- 6.9
EM (MSCI)*	1.00	1.00	1.89	na	848.2	+1.5	+ 20.1	+ 20.1
EMBI+†	1.00	1.00	1.89	na	401.8	+0.3	+ 9.0	+ 9.0

*Emerging Mkts. †JPMorgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Trading market value.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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